No.

IN THE

# Supreme Court of the United States

SSW, INC.,

*Petitioner,*

v.

REGENTS OF THE UNIVERSITY OF CALIFORNIA,

*Respondent.*

On Petition For Writ Of Certiorari
To The Supreme Court of California

## PETITION FOR WRIT OF CERTIORARI

KERRY L. KESTER
*Counsel of Record*
JOEL D. HEUSINGER
KRISTA L. KESTER
WOODS & AITKEN, L.L.P.
SUITE 500
301 SOUTH 13TH STREET
LINCOLN, NE 68508-2578
(402) 437-8500

MICHAEL E. LONDON
MCINERNEY & DILLON, P.C.
ONE KAISER PLAZA
18TH FLOOR
OAKLAND, CA 94612
(510) 465-7100

## QUESTION PRESENTED

I. To what extent does the FAA permit state courts to displace federal arbitration law in order to avoid enforcement of an arbitration agreement?

A. Where parties to a contract involving interstate commerce designate state law as the rule of decision for some aspect of the contract, whether federal arbitration policy and the Supremacy Clause are offended by a judicial presumption that such designation evidences the parties' clear intent to displace federal arbitration law with conflicting state law.

B. Whether state courts may utilize state law to stay arbitration in favor of litigation where the contracting parties have expressly agreed that federal arbitration law would apply to the enforcement of the arbitration agreement without limitation by state law.

## LIST OF PARTIES AND AFFILIATES

The following were parties to the proceeding in the Supreme Court of California:

SSW, Inc. – Petitioner/Appellant below

Regents of the University of California – Respondent/Appellee below

In addition, Tuthill, Inc. is a defendant in the Superior Court case and participated as an appellant in the appeal to the California Court of Appeal, but not in the California Supreme Court. Fidelity & Deposit Company of Maryland and Universal Underwriters Insurance Company are defendants in the underlying Superior Court case, but did not participate or enter an appearance in the proceedings before the California Court of Appeal or the California Supreme Court.

Petitioner, SSW, Inc., has no parent corporation and no publicly held company owns ten percent or more of the stock of SSW.

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## BASIS OF JURISDICTION

This Court has jurisdiction pursuant to 28 U.S.C. § 1257(a) and 9 U.S.C. § 16(a). First, this petition for a writ of certiorari arises from the denial of SSW's petition to compel arbitration. Such a denial is an appealable order pursuant to 9 U.S.C. § 16(a). Second, on May 18, 2005, pursuant to Cal. Rules of Court 29.3(b), the Supreme Court of California entered final judgment as to the petition to compel arbitration by dismissing its prior order granting review of the court of appeal decision. According to Cal. Rules of Court 29.4(b)(2)(B), a dismissal of review pursuant to Cal. Rules

[1] The decision in *Cronus Investments, Inc. v. Concierge Services* is published at 107 P.3d 217 (Cal. 2005), and appears for the Court's convenience in the attached Appendix at App. 27a.

of Court 29.3(b) constitutes a final decision by the California Supreme Court upon the filing of that dismissal.

## RELEVANT STATUTORY PROVISIONS

The Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-16, was intended to ensure that this nation's courts enforce arbitration agreements according to the intent of the parties. More specifically, 9 U.S.C. § 2 provides that, in contracts involving interstate commerce, agreements to settle controversies through arbitration "shall be valid, irrevocable, and enforceable, save upon grounds as exist at law or in equity for the revocation of any contract." *Id.*

Additionally, Cal. Civ. Proc. Code § 1281.2(c) permits California courts to stay arbitration proceedings where "[a] party to the arbitration agreement is also party to a pending court action or special proceeding with a third party, arising out of the same transaction or series of transactions and there is a possibility of conflicting rulings on a common issue of law or fact." *Id.*

## STATEMENT OF THE CASE

This Petition does not contend that the decision in *Volt Information Sciences, Inc. v. Board of Trustees*, 489 U.S. 468 (1989), was erroneous or that the FAA preempts section 1281.2(c) generally. In fact, the Petitioner accepts the essential holding of *Volt* that, *when chosen by the contracting parties*, section 1281.2(c) may be used to stay arbitration in favor of litigation.

Rather, this Petition seeks judicial review of the manner in which arbitration rights are being burdened by the California courts through the use of a de facto presumption

that the courts are not bound by parties' selection of non-California law in an arbitration clause, but instead may apply section 1281.2(c) to stay arbitration without regard to and in contravention of the parties' express choice of law. Such a presumption is completely at odds with this Court's determination in *Volt* that state law, rather than the FAA, could be applied to arbitration agreements *where the parties have so agreed.* The California presumption blatantly disregards contractual choice-of-law clauses and, instead, utilizes California's stay provision to frustrate and defeat the parties' stated intentions, in contravention of *Volt*, the FAA, and the Supremacy Clause.

Thus, rather than challenge the merits of the decision in *Volt*, the Petitioner here seeks to have *Volt's* central holding affirmed, clarified, and imposed upon the California courts so as to require all courts to give effect to the parties' stated intention to have the FAA (or some other law) govern their arbitration agreement without limitation by California law.

### *Statutory Background*

"The central purpose of the Federal Arbitration Act [is] to ensure 'that private agreements to arbitrate are enforced according to their terms.'" *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 53-54 (1995). While parties had been free to enter into agreements to arbitrate disputes without the benefit of the FAA, its enactment was deemed necessary by Congress to overcome "the judiciary's longstanding refusal to enforce agreements to arbitrate." *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 219-20 (1985); *Volt*, 489 U.S. at 478. To that end, § 2 of the FAA provides that a written agreement to arbitrate in a contract involving interstate commerce or a maritime transaction is "valid, irrevocable, and enforceable, save upon such grounds

as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Moreover, § 2 applies both in state and federal courts. *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 272 (1995) (reaffirming the application of § 2 to state courts as announced in *Southland Corp. v. Keating*, 465 U.S. 1, 12-15 (1984)).

As this Court has explained, the FAA permits and empowers contracting parties to "trade" the usual rules and procedures attendant to courtroom litigation for the relative "simplicity, informality, and expedition of arbitration." *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 31 (1991) (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985)).

Accordingly, all courts are required to "enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms." *Volt*, 489 U.S. at 479. In fact, such enforcement is to be "rigorous" in order to give effect to the contractual agreement. *Id.* at 221 (quoting *Dean Witter*, 470 U.S. at 221). This is so "notwithstanding the presence of other persons who are parties to the underlying dispute but not to the arbitration agreement." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 20 (1983). Thus, the FAA does not retreat where "piecemeal" resolution of disputes might result from the enforcement of an agreement to arbitrate. Quite to the contrary, the FAA "*requires* piecemeal resolution when necessary to give effect to an arbitration agreement." *Id.* (emphasis in original).

### *The Supreme Court Decision in Volt*

In a series of cases during the 1980s, the Court emphasized the FAA's unyielding requirement that arbitration agreements be enforced according to their terms. *See Moses H. Cone*, 460 U.S. 1; *Southland v. Keating*, 465 U.S. 1; *Perry v. Thomas*, 482 U.S. 483 (1987). In each of those cases, the Supreme Court reversed lower court decisions, requiring that the FAA be given effect and that the arbitration agreements at issue be enforced to the exclusion of any conflicting provisions of state law. *Moses H. Cone*, 460 U.S. at 24; *Southland v. Keating*, 465 U.S. at 12; *Perry v. Thomas*, 482 U.S. at 491.

Those cases precipitated an argument that parties could not agree to have their arbitration bound by any rules or law *other than* the FAA. The issues presented in *Volt* squarely framed the misapprehension of the earlier cases and the Court took occasion to clarify the interaction between state law and the FAA. 489 U.S. 468. *Volt* presented the first reported dispute over the use of a choice-of-law provision to stay arbitration under section 1281.2(c) on the ground that the existence of both arbitrable and nonarbitrable claims created an impermissible risk of inconsistent results if the arbitration was permitted to proceed. The contract in *Volt* contained a general choice-of-law provision calling for California law to govern the contract. The arbitration clause did not otherwise limit the application of California law or specify any other law to govern the arbitration agreement. The trial court concluded that the contract revealed the parties' intention to use California law in all respects, including the stay provision of section 1281.2(c).

This Court reiterated that, in applying general state-law principles of contract construction to an arbitration

agreement within the scope of the Act, "due regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the arbitration clause itself resolved in favor of arbitration." *Volt*, 489 U.S. at 475-76. However, within that framework, the parties to a contract are quite capable of choosing procedures other than those of the FAA to govern the arbitrability of their claims. *Id.* at 476-77. In so holding, the Supreme Court declined to consider whether, in fact, the parties had so agreed; rather, the Court ***assumed*** that the state court's interpretation of the arbitration agreement was correct and that the parties had "agreed to abide by state rules of arbitration." *Id.* at 479; *see also id.* at 477 (noting that the parties had "agreed to arbitrate in accordance with California law").

Justice Brennan's concerns, expressed throughout his dissent in *Volt*, portrayed clearly the method by which state courts might eviscerate the rights thought to be guaranteed by the FAA. Justice Brennan warned that through the façade of contract interpretation state courts would be given license to refuse enforcement of arbitration agreements. Justice Brennan was concerned that contract construction would be used wrongly to attribute to parties intentions clearly at odds with their arbitration agreement and their stated intentions to resolve all of their disputes without resort to litigation. That is precisely the result of the line of California appellate cases decided since *Volt*.

Nevertheless, in the absence of evidence that the California courts were acting other than in deference and respect to the FAA, the majority did not find Justice Brennan's warnings to be compelling. However, the judicial restraint observed by the majority in *Volt* does not, and should not foreclose a critical analysis of the liberties that have been taken recently by the California courts to stay

arbitration using California law notwithstanding parties' stated intent to the contrary.

### *Factual Background in the Instant Case*

In 1994, SSW entered into a subcontract with Walsh Construction Co. ("Walsh") with respect to a construction project for the University of California. The subcontract included an arbitration agreement that specified arbitration as the sole mechanism for the resolution of disputes arising from the subcontract.[2] The prime contract between Walsh and the University did *not* contain an arbitration agreement.

Problems arose on the Project and, in 1999, the Board of Regents ("Regents") brought suit against Walsh in the California Superior Court for, among other things, breach of contract. Two years later, the Regents, acting as a purported third-party beneficiary, amended its complaint to include claims against SSW for alleged breaches of contract and warranty.

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[2] The SSW subcontract arbitration agreement provides, in pertinent part:

> If the foregoing procedures do not resolve the dispute, the dispute shall be decided by arbitration in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association then prevailing as supplemented by Section 1282.6, 1283, and 1283.05 of the California Code of Civil Procedure. Selection of arbitrators shall be in accordance with rules of the American Arbitration Association. The Arbitrators shall be bound by, and apply California law. . . . The foregoing agreement to arbitrate and any other agreement to arbitrate with an additional person or persons duly consented to by the parties hereto shall be specifically enforceable under the prevailing Arbitration Law. . . .

App. 6a.

SSW promptly filed a petition to compel arbitration.[3] The superior court denied the petition on the ground that the subcontract's general choice-of-law clause rendered the FAA inapplicable and permitted a stay of the arbitration pursuant to Cal. Civ. Proc. Code § 1281.2(c). App. 25a-26a. The California Court of Appeal affirmed the decision staying arbitration, thereby refusing to enforce the arbitration agreement as would be required by the FAA. App. 23a.

Following the court of appeal's decision, the California Supreme Court granted SSW's request for further review and simultaneously deferred further action on the case pending disposition in *Cronus Investment, Inc. v. Concierge Services, LLC.*, another case involving application of section 1281.2(c) to a contract in which the parties' arbitration agreement specified that it would be governed by the FAA. App. 2a.

Arguments were heard in *Cronus* in January 2005 and a decision was rendered in March 2005. Two months later, the California Supreme Court dismissed review of SSW's appeal "[i]n light of the decision in *Cronus Investments, Inc. v. Concierge Services* (2005) 35 Cal. 4th 376." App. 1a. No other rationale was given for the adjudication in *SSW*. Thus, the court's adjudication of *SSW* can only be understood through the ultimate holding in *Cronus*.[4]

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[3] SSW also demurred on the ground that the subcontract specifically foreclosed the creation of any third-party beneficiary relationship, such as the one upon which the Regents based their suit against SSW. The Superior Court's denial of the demurrer was not immediately appealable and is not at issue in this case.

[4] The courts routinely establish the principles and analysis relevant to a particular case by summarily disposing of the matter "in light of" another decision or legislative action. *See, e.g., Blankenship v. Parratt*, 490 U.S. 1088 (1989) (granting certiorari and remanding to court of appeals for

For the avoidance of doubt, SSW's petition for a writ of certiorari does *not* revolve around the superior court's construction of the contract and the arbitration provision therein – as erroneous as SSW believes that construction to be. Rather, SSW's petition for a writ of certiorari springs from the California Supreme Court's subsequent application of a *de facto* presumption that California procedural law will supplant the FAA irrespective of the particular law chosen by the parties in the arbitration agreement. The presumption is invoked even where the parties' contract indicates that the FAA, rather than California law, is selected to govern the arbitration agreement.

### *The Decision in Cronus v. Concierge Services*

The court in *Cronus* confirmed that the contract's general choice-of-law provision (selecting California law)

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further consideration "in light of" decision in a case raising the same issues).

The California Supreme Court, pursuant to Cal. Rules of Court 29.3(b), could have ordered the publication of the court of appeal decision if the opinion below was intended to be the law of the State. *See also* Cal. Rules of Court 976(c) and 976.1 (outlining purposes for which court of appeal decisions may be published).

However, in this instance, the California Supreme Court, by specifically referencing its decision in *Cronus* instead of deferring to the opinion of the Court of Appeal in *SSW* and requesting publication of that decision, indicated that its decision in *Cronus*, not the Court of Appeal opinion in *SSW*, is the law of the State of California. *Compare Grace v. eBay*, 101 P.3d 509 (Cal. 2004) (dismissing review and remanding to court of appeal without further reference to any legal authority or decision) *with People v. Williams*, 113 P.3d 532 (2005) (vacating Court of Appeal decision "in light of" another California Supreme Court decision) and *Lockheed Martin Corp. v. S.C. (Adams)*, 96 P.3d 29 (Cal. 2004). Therefore, we must look to the decision in *Cronus*, as well as the decision in the Court of appeal to truly understand the full legal ramifications of the dismissal of review in the underlying case.

was superseded by the more specific language of the arbitration agreement, and that the parties had intended for the FAA to apply to the "fullest extent" and "without limitation" to the arbitration agreements, notwithstanding the contract's general choice-of-law provision. App. 31a. In fact, the court noted that the parties "agreed" that the FAA limited the applicability of California law otherwise called for in the general choice-of-law clause. App. 39a.

However, *in spite of the parties express agreement that the FAA was intended to govern*, the California Supreme Court refused to give effect to § 2 of the FAA and, instead, applied section 1281.2(c) to stay the arbitration while forcing the parties to resolve their disputes in litigation rather than arbitration – a result absolutely repugnant to the FAA.

In addition, the court embraced the opportunity to upend *Volt's* long-standing rule by holding that state arbitration provisions (rather than the FAA) would apply by default to the procedural aspects of the arbitration *unless* the parties "expressly" designated that the FAA was to apply. App. 50a. That ruling is diametrically opposed to this Court's holding that requires application of the *FAA* unless the parties clearly express an intention to have *state law* supplant the rights afforded by the FAA. *Volt*, 489 U.S. at 475-478; *Perry v. Thomas*, 482 U.S. at 491; *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 688 (1996); *Mastrobuono*, 514 U.S. at 56-58.

***California Supreme Court Decision in SSW***

In light of the rules articulated in *Cronus*, the California Supreme Court's decision in *SSW* did not require any further analysis of the issues on review because state law, including section 1281.2(c), would apply to the arbitration as a result

of the general choice-of-law clause irrespective of whether the parties intended that federal law, rather than state law, govern the enforcement of their arbitration agreement.

The facts in *SSW* parallel those in *Cronus*. Here, the contract contains a general choice-of-law provision selecting California law. In addition, the arbitration agreement refers to California law in two specific manners, neither of which related to the enforcement of the agreement to arbitrate. First, three specific sections of the California Civil Code of Procedure relating to subpoenas were invoked to supplement the Construction Industry Rules of the American Arbitration Association. Second, the arbitrators were to be "bound by and apply" California law. On the other hand, enforcement of the arbitration agreement was to be governed, not by California law, but by "Arbitration Law." App. 7a. The lower courts construed the parties' intentions to be that *all* California law applied by virtue of the general choice-of-law provision. App. 20a-23a, 25a-26a.

However, the California Supreme Court did not examine or opine on the lower courts' conclusions, which turned upon the interpretation of the arbitration agreement. Instead, the court relied solely upon its decision in *Cronus* to reject SSW's petition to compel arbitration.

The *Cronus* decision had openly rejected the parties' contractual agreement as to the law that would govern the arbitration agreement and, instead, presumptively applied California law *as a default*.

According to *Cronus*, California procedural law would be invoked to stay the arbitration irrespective of the law selected by the parties to govern the enforcement of the arbitration agreement. *See* App. 39a-50a. Notwithstanding

the parties' expression of which rule or law to apply to specific aspects of the arbitration, those designations apparently were not sufficiently express to be an "express designation" of the procedural law to be applied. Thus, the California court defaulted to the California provisions, including section 1281.2(c), which effectively negates SSW's right to arbitrate without ever determining whether the parties intended for state or federal law to apply.

The California Supreme Court found no need to determine whether SSW and Walsh intended their arbitration agreement to be governed by state or federal arbitration law because, as *Cronus* established, section 1281.2(c) should be applied regardless of the terms of the parties' contract. That is, the court presumed the parties intended such a result from the existence of the general choice of law clause.

The California Supreme Court's decision in *SSW*, as it springs from *Cronus*, evinces a conclusion even more disruptive to the intent of the contracting parties than was the California court of appeal's decision in *SSW*. While the court of appeal at least hinged its decision on the particular wording of the arbitration agreement, and in SSW's opinion incorrectly determined the intent of the parties, the California Supreme Court concluded that section 1281.2(c) should apply *irrespective* of the intent of the parties.

Together with the decision in *Cronus*, the underlying decision in *SSW* acts to further widen the gulf between California state courts and nearly every other jurisdiction, as it relates to enforcement of arbitration agreements, application of federal law in state forums, and interpretation of arbitration agreements which involve interstate commerce.

## REASONS FOR GRANTING THE PETITION

Review is warranted in this case to curb the recent practice in the California courts of discriminating against federal arbitration rights and grossly distorting the rule articulated in *Volt*. Apparently believing that *Volt* authorized unlimited license to apply state law to arbitration agreements, California courts routinely impose on parties a *presumption* that California arbitration law is preferred over Federal law. That presumption also makes applicable California state law rules of procedure and permits the courts to stay arbitration pursuant to those rules irrespective of the parties' express agreement that the FAA is to apply without limitation by state law. Such discriminatory construction of arbitration agreements is prohibited by the FAA, where the FAA is not displaced by the parties themselves.

To be sure, the California courts continue to give lip-service to the premise that arbitration agreements be construed with "due regard" to the federal policy favoring arbitration and that federal law requires that "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration." *Cronus*, App. 34a-37a. However, in actuality, the California courts require that the parties clearly express their adoption of federal law rather than California law, even though this Court consistently has required precisely the opposite. *Volt*, 489 U.S. at 478-479 (establishing that, to displace the FAA, parties must clearly express their intent to reject the FAA and adopt state law).

Moreover, a survey of cases decided by the California courts since *Volt* reveals that the California courts consistently and virtually without exception have refused to find contract language sufficient to express the requisite "clear adoption" of federal law. The presumption that

California arbitration law is to be preferred turns the Supremacy Clause on its head, defaulting to California arbitration law in circumstances of ambiguity and even where there is a clear indication that the parties intended federal law to apply.

Additionally, the Court should review the underlying decisions because the principles of contract construction employed by the California courts in such instances effectively nullify federal arbitration rights. This Court is not powerless to scrutinize and annul state court actions that displace federal rights.

## I. REVIEW IS NECESSARY IN ORDER TO CONSIDER WHETHER THE SUPREMACY CLAUSE IS OFFENDED BY A DE FACTO PRESUMPTION THAT DISPLACES FEDERAL LAW IN FAVOR OF CALIFORNIA LAW.

In a series of recent decisions, culminating in the recent decision in *SSW*, the California courts have enforced an arbitrary presumption that renders enforcement of an arbitration agreement virtually impossible if the contracting party is susceptible to suit in California – particularly if the contract includes any type of choice-of-law clause indicating the selection of California law for *any* purpose, whether narrowly or broadly drafted. The application of *Volt* by California courts has evolved to the point that practitioners can routinely join in litigation parties with whom they have arbitration agreements with *non-arbitrating* third parties in order to defeat pending arbitration demands.

California courts have taken this tact even where the law of a different jurisdiction is chosen by the parties and when such other jurisdictions would enforce arbitration and stay

the litigation as a matter of law. That is, California courts preclude arbitration under the FAA based on the fiction that the parties whose contracts contain choice-of-law clauses choosing even non-California state law must, therefore, intend *not* to arbitrate in accordance with the FAA.

The presumption of intent to displace federal law offends and violates the Supremacy Clause because the presumption effectively preempts federal law in favor of inconsistent and conflicting state law principles.

### A. The Supremacy Clause Voids Any State Law, Whether Judicial Or Legislative In Origin, That Burdens Federal Rights.

Although the United States is a republic holding fast to the rights of the various states, federal law – duly enacted in accordance with the United States Constitution – unquestionably enjoys through the Supremacy Clause a position of authority superior to that of state law. U.S. Const. art. VI, cl. 2. More particularly, the Supremacy Clause prohibits application of state rules that conflict with or displace otherwise applicable federal rights or law. Such provisions "must give way" to federal rights. *Perry v. Thomas*, 482 U.S. at 490. Were the rule anything else, the Supremacy Clause would be emptied of its primacy by permitting state judicial or legislative pronouncements to invalidate and deny rights created by federal law. *See Walker v. City of Birmingham*, 388 U.S. 307, 338 (1967) (Brennan, J. dissenting).

This Court has confirmed repeatedly that the right to enforce a contractual arbitration agreement by its terms is protected by federal law through the enactment of the FAA. As noted in *Perry v. Thomas*, the FAA "embodies Congress'

intent to provide for the enforcement of arbitration agreements within the full reach of the Commerce Clause." 482 U.S. at 490. In fact, "the preeminent concern" of Congress in passing the FAA was to enforce "rigorously" such private agreements. *Id.* (declaring California law that required judicial forum for resolution of wage disputes in the face of an arbitration agreement to be preempted by the FAA).

Where state rules conflict with federal law, the Supremacy Clause voids the substantive rule that would have the effect of displacing federal rights. Quite simply, federal law *will not* be rendered impotent by state law. Rather, it is the competing state law principle – whether it be of judicial or legislative creation – that must yield so as to permit full enjoyment of those rights (and obligations) created by federal law.

### B. The Presumption Invoked By California Courts Conflicts With And Displaces The FAA's Requirement That Arbitration Agreements Be Enforced According To Their Terms.

The California state courts have created and enforced a de facto presumption that applies California state law to frustrate a party's right to enforce an arbitration agreement under the FAA, irrespective of the particular law chosen by the agreement of the parties. *See Cronus*, App. 27a; *Frankhouse v. Roth Capital Partners, LLC*, No. G033765, 2005 WL 1406004 (Cal. Ct. App. June 16, 2005). In its barest terms, the judicially created presumption provides that, so long as an action is pending in the California state courts:

> Enforcement of a contractual agreement to arbitrate will be determined by application of *California* procedural law without regard to other provisions of the arbitration agreement that invoke federal law or some other state law to govern the agreement.

To be sure, the courts have not labeled the presumption as such. Yet operation of the presumption is instantly recognizable from recent California court decisions.

1. **The presumption operates where the parties have selected California law with respect to any aspect of their contract, even if the arbitration clause specifies a different body of law.**

The presumption is most frequently invoked (although as explained below, not exclusively invoked) where the parties have included within the contract a general choice-of-law provision selecting California law to govern the contract. *See, e.g., Cronus*, App. 27a; *Mount Diablo Med. Ctr. v. Health Net of Cal., Inc.*, 124 Cal. Rptr. 2d 607 (Cal. Ct. App. 2002). The courts have asserted that those cases logically flow from the holding in *Volt*. However, that rationale rings hollow. Quite apart from the Court's teaching in *Volt* that requires the court to give effect to the parties' agreement, the California courts have simply given effect to California procedural law, whether or not the parties selected it to govern the arbitration agreement.

As discussed above, the recent decision in *Cronus* illustrates that, so long as the parties to an arbitration agreement are amenable to suit in California, those parties are presumed by the courts to have intended for California law to apply and for the courts to have discretion to stay

arbitration. *See supra* at 27a. This presumption was utilized in *Cronus* to defeat federal rights granted by the FAA despite the court's recognition that the parties had agreed that California law was *not to apply* to the arbitration agreement. The court further noted in *Cronus* that California usurped federal law in that instance because federal law (the law chosen by the parties) was inconsistent with California law. App. 27a.

The origins of the presumption can be seen in the court of appeal's decision in *Mount Diablo*, 124 Cal. Rptr. 2d at 607. An earlier California court of appeal decision had correctly recognized *Volt* as having application only where the parties had clearly expressed in the contract their intention to be governed by California procedural rules relating to arbitration. *See Warren-Guthrie v. Health Net of Cal., Inc.*, 101 Cal. Rptr. 2d 260 (2000). In resolving a motion to compel arbitration, the court in *Warren-Guthrie* declined to apply section 1281.2(c) because the arbitration provision contained express language that California arbitration law was applicable only with respect to the manner in which the arbitration was to be "conducted," as distinguished from agreeing that California arbitration law was to apply for all purposes. *Id.* at 268-69.[5]

However, that decision was rejected three years later by a different panel of judges in *Mount Diablo*, 124 Cal. Rptr. 2d at 615.[6] In contrast to the measured decision in *Warren-*

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[5] The arbitration provision stated: "All Arbitration shall be conducted in accordance with the California Code of Civil Procedure, commencing with Section 1280." *Warren-Guthrie*, 101 Cal. Rptr. 2d at 268.

[6] The decision in *Mount Diablo* was authored by Judge Pollak, who also had ruled upon SSW's petition to compel arbitration in 2001 prior to his appointment to the court of appeal.

*Guthrie*, the court in *Mount Diablo* determined that a general choice-of-law clause that called for California law to govern the "enforcement" of the contract constituted an expression of intent for California arbitration law to also govern the enforceability of the arbitration agreement.[7] *Id.* at 615. Accordingly, the petition to compel arbitration in that case was denied.

What is most interesting is that the foundation for the decision in *Mount Diablo* was the fact that the choice-of-law provision referenced "enforcement" of the contract in general, although there was no specific reference to enforcement of the arbitration agreement. The court determined that a designation of law for purposes of the enforcement of the contract was sufficient to also evidence intent to have that law apply to the enforcement of the arbitration agreement, in the absence of any other designation of law.

However, that rationale was abandoned by the California courts when the same issues later arose in *Cronus* and *SSW*. In those cases, the arbitration provisions themselves designated the body of law to govern the enforcement of the arbitration agreement. In fact, in *Cronus*, the arbitration agreement stated that federal law was not to be limited by the designation of state law for any purpose. *Cronus*, App. 31a. Under the reasoning of *Mount Diablo*, the law designated for enforcement of the arbitration agreement would have been given effect without question in *Cronus* and *SSW*.

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[7] The choice of law provision in *Mount Diablo* was separate from the arbitration agreement and stated only that that "validity, construction, interpretation and enforcement of this Agreement shall be governed by the laws of the State of California." *Mount Diablo*, 124 Cal. Rptr. 2d at 609.

But the reasoning of *Mount Diablo* was not followed. Instead, the court used *Cronus* to articulate the presumption that permits courts to displace the FAA with state law, and then applied that presumption in *SSW*.

**2. The California courts also have employed the presumption that California law applies, including section 1281.2(c), when the parties have contractually selected state law *other than* California.**

The California court of appeal recently established the *irrebuttable* nature of the presumption in *Frankhouse*, 2005 WL 1406004, where the court used section 1281.2(c) to stay arbitration even though the only choice-of-law provision in the contract selected another state's law to govern the contract.

*Frankhouse* presented a situation where both arbitrable and non-arbitrable claims were pending against the defendants and, hence, the prospect that the claims could not be resolved in a single forum. *Id.* at *3-5. The contract selected New York law to govern the contract, and did not mention in any manner California law. *Id.* at *5. Nor was there apparently a forum selection clause that required the dispute to be heard in California. *Id.*

Notwithstanding its conclusions that the arbitration clause was contained in a contract involving interstate commerce and was thus subject to the FAA, and that New York law was selected by the parties, the court applied *California* law over either New York or federal law, and stayed the arbitration pursuant to section 1281.2(c). *Id.* at *5-6.

Without question, the court in *Frankhouse* strained to reach its result. First, the courts in essence presumed that California law should apply to the arbitration agreement in spite of the parties' selection of New York law to govern their contract and the absence of any mention of California law in the contract.

Second, the court justified its application of California state law (even though the parties had wholly ***excluded*** California law from their agreement) on the premise that *Volt* allowed the parties to agree to apply state law over the FAA. *Id.* at *6. Yet, the parties in *Frankhouse* had expressly chosen ***New York*** law, not California law.

To the extent that the court in *Frankhouse* might not have known New York law, the resolution was easily found in this Court's recognition that § 2 of the FAA is a declaration of the "liberal federal policy favoring arbitration agreements" and that ambiguities or uncertainties with respect to arbitrability must be resolved with a healthy respect for arbitration under the FAA. *Moses H. Cone*, 460 U.S. at 24. However, rather than default to the FAA, the court in *Frankhouse* applied California law despite the parties' selection of New York law.

Thus, notwithstanding the supreme court's assurance that parties ***can*** contract out of section 1281.2(c)'s application by expressly designating the application of state law ***other than California***, *see Cronus*, App. 50a, it is abundantly clear that any such attempt to contractually specify application of the FAA will be rebuffed and rejected by the California courts. The "assurance" is, undoubtedly, illusory.

More recently, this presumption also has been applied to discriminate against federal arbitration rights in general, not just those involving multi-party litigation that would invoke the stay provisions of section 1281.2(c). *See, e.g., Discover Bank v. Super. Ct.*, 113 P.3d 1100 (Cal. 2005) (disregarding contractual selection of Delaware law with respect to enforceability of class action waiver in order to invite conflict of law analysis).

### C. The FAA Does Not Authorize The Presumption That California Law Displaces Federal Law In The Enforcement Or Conduct Of An Arbitration.

The presumption that has been developed and employed by the California courts is in direct conflict with the FAA and with this Court's decisional law. The Supremacy Clause pointedly invalidates state law that conflicts with federal law or burdens rights afforded by federal law. The presumption employed by the California courts runs afoul of the FAA and the Supremacy Clause because it imposes precisely that burden upon federal arbitration rights.

The myth that 1281.2(c) merely alters the timing of arbitration, without affecting the contracting party's ability to resolve an arbitrable dispute through that forum, is specious. Without question, the California courts have and continue to use section 1281.2(c) to require that arbitration sit on the sideline while litigation goes forward in order to "prevent inconsistent results." However, that rationale illustrates that the very issues being litigated are those that were intended by the parties to be arbitrated. Moreover, the preclusive effect of litigation is such that the arbitrator will have nothing to do but enter findings based upon the litigation without permitting the parties to resolve the

arbitrable issues in the forum that was contractually agreed. *See Mount Diablo*, 124 Cal. Rptr. 2d at 618 (recognizing that, having been brought within the court's jurisdiction despite its arbitration agreement, the party will be "bound by the outcome and undoubtedly will find it in its best interest to defend the litigation").

As noted at the outset of this petition, the critical issue here is not the application of contract construction principles by the California courts. Rather, the issue is the manner in which the California courts have nullified the federal arbitration rights by applying section 1281.2(c) despite having determined that the contracting parties did not choose California law to govern their arbitration agreement.

This case presents an appropriate vehicle for further refinement of the majority's opinion in *Volt* that contracting parties can provide for the application of law other than the FAA. The majority decision in *Volt* neither precludes nor resolves the issues presented by this case. First, *Volt* is a picture of judicial restraint. The Court appropriately limited its holding to the facts and the issues raised by the parties. The challenge in *Volt* was directed to the validity of section 1281.2(c), *vis-à-vis* the FAA. The Court rejected the notion that *Moses H. Cone* stood for the principle that federal law required arbitrations to be fully governed by federal law, and held that section 1281.2(c) was not preempted by the FAA to the extent that the parties had agreed to the application of that state law provision to their contract and arbitration agreement.

Without this Court's review and refinement, parties who find themselves before California courts will continue to have virtually no ability to enforce an arbitration provision,

even if they have specifically contracted to have the FAA, rather than state law, govern their arbitration agreement.

Although the surrounding circumstances may not have warranted such scrutiny in 1989, *see Volt*, 489 U.S. at 476, 481, the California cases decided during the past five years give ample basis for such consideration. *See, e.g., Cronus*, App. 27a; *SSW*, App. 4a; *Frankhouse*, 2005 WL 1406004; *Mount Diablo*, 124 Cal. Rptr. 2d 607.

### 1. This court properly may review the California courts' decisions, even if they do implicate contract interpretation, because the contract affects important federal rights.

Even to the extent that certiorari in this case requires review of contract interpretation by state courts, the general deference paid by this Court to state court decisions on contract interpretation is not unlimited. This Court can and should examine the manner in which state courts are construing contracts in order to guard against the arbitrary denial of federal rights.

Generally, the Supreme Court affords "respectful consideration and great weight to the views of the States' highest court" as to the formation and construction of contracts under state law. *GMC v. Romein*, 503 U.S. 181, 187 (1992). However, the Supreme Court is "ultimately bound to decide for [itself] whether a contract was made." *Id.* (quoting with approval *Indiana ex rel. Anderson v. Brand*, 303 U.S. 95, 100 (1938)).

In the same way, even though meaning and effect of a contract are questions generally settled by state courts, that rule does not apply universally. Rather, the Supreme Court,

"in the performance of its duty to safeguard an asserted constitutional right, may inquire whether the decision of the state question rests upon a fair or substantial basis." *Memphis Gas Co. v. Beeler*, 315 U.S. 649, 654 (1942). "[T]he exercise of jurisdiction by this Court to protect constitutional rights cannot be declined when it is plain that the fair result of a decision is to deny the rights. It is well known that this Court will decide for itself whether a contract was made as well as whether the obligation of the contract has been impaired." *Rogers v. Alabama*, 192 U.S. 226 (1904). *See also James v. Ky.*, 466 U.S. 341, 349 (1984) (quoting with approval *Davis v. Wechsler*, 263 U.S. 22, 24 (1923) (Holmes, J.) ("The assertion of federal rights, when plainly and reasonably made, is not to be defeated under the name of local practice.").

Consequently, the Supreme Court is not obligated to accept the edict of a state court when federal rights are burdened thereby.

The Court's jurisdiction and obligation are not altered in this case by the mere fact that the federal right at issue is statutory rather than constitutional. Where "the existence or application of a federal right turns on a logically antecedent finding on a matter of state law, it is essential to the Court's performance of its function that it exercise an ancillary jurisdiction to consider the state question. Federal rights could otherwise be nullified by the manipulation of state law." Wechsler, *The Appellate Jurisdiction of the Supreme Court: Reflections on the Law and the Logistics of Direct Review*, 34 Wash. & Lee L. Rev. 1043, 1052 (1977).

2. **Judicial review in this case is crucial because the manner in which California courts have enforced contracts has the effect of nullifying the federal arbitration rights guaranteed by the FAA.**

The Commerce Clause aims to preserve a national market for competition undisturbed by preferential advantages" created by state law, *GMC v. Tracy*, 519 U.S. 278, 299 (1997), and was designed to avoid altering the terms upon which business interests must compete based upon the particular state in which the business was conducted. *Accord Grandholm v. Heald*, ___ U.S. ___, 125 S. Ct. 1885 (2005). Thus, states are not permitted, through application of local law, to discriminate against the right to enforce a contractual arbitration agreement that was created by § 2 of the FAA.

The burden being imposed upon federal arbitration rights by the California courts has been exhaustively discussed above. Most importantly for this discussion, that burden is based upon oblique references to the majority's decision in *Volt* and is being imposed in the name of "contract interpretation." Notably, the burdens exposed by the decisions in *SSW* and *Cronus* are the very same burdens about which Justice Brennan voiced concern in his dissenting opinion in *Volt*. And, while the majority did not find those concerns compelling under the facts in *Volt*, the record of judicial action now before the Court provides evidence that Justice Brennan's fears have, in fact, become reality. This case provides the appropriate vehicle to resolve the manner in which contracting parties must express their intention to have federal arbitration law govern their agreement, whether enforcement of that agreement is sought in California or any other jurisdiction.

In fact, Justice Brennan was nothing short of clairvoyant when he asserted that judicial review of the state court's contract interpretation was equally appropriate with respect to arbitration matters as in matters involving impairment of constitutional rights. *See Volt*, 489 U.S. at 482-84 (Brennan, J., dissenting). As he cautioned in 1989, "the right of the instant parties to have their arbitration agreement enforced pursuant to the FAA could readily be circumvented by a state-court construction of their contract as having intended to exclude the applicability of federal law." *Volt*, 489 U.S. at 484. Moreover, Justice Brennan cautioned that, if unchecked, the use of unprincipled contract interpretation could essentially strip the FAA of any application in the hands of state courts:

> Were every state court to construe such clauses as an expression of the parties' intent to exclude the application of federal law, as has the California Court of Appeal in this case, the result would be to render the Federal Arbitration Act a virtual nullity as to presently existing contracts.

*Id.* at 491.

The hostile climate toward arbitration agreements that parties now find in the California courts implicates precisely the concerns voiced by Justice Brennan in his dissent in *Volt*. To be sure, SSW is willing to accept, for purposes of this discussion, that the contract interpretation given by the Court of Appeal in *Volt* was correct and that the parties had intended through their general choice-of-law provision for section 1281.2(c) to apply. However, the recent decisions of the California Supreme Court reveal a persistent practice of *abandoning* the intention expressed by the parties and

applying California law, and particularly section 1281.2(c), without regard to the parties' clearly expressed intentions to the contrary. In *Cronus*, the court specifically disregarded the parties' agreement that federal law was to apply ***without limitation*** by California law. *Cronus*, App. 31a, 39a-50a.. In *SSW*, the court did not even engage the analysis of the parties' intent because (as shown in *Cronus*) California law would apply irrespective of the parties' agreement.

The analysis applied by the California Supreme Court has resulted consistently in the decision that California law was intended to apply so as to permit a stay of arbitration, even though the FAA does not contemplate such a result. That analysis simply cannot be regarded as a legitimate exercise of state court contract construction. Rather, it is a denigration of both contract rights as well as federal arbitration rights.

However, the absence of principled contract interpretation is not the basis for SSW's prayer for judicial review in this Petition. Rather, it is both permissible and essential that the Supreme Court consider and review California's rule that defaults to California procedure because such rule has the effect of nullifying federal rights.

The California courts now have rendered virtually impossible the enforcement of an arbitration agreement where there are related but non-arbitrable claims asserted by one of the parties to the arbitration agreement. The court's analysis of the contract in *Cronus* confirms that parties ***cannot***, irrespective of the careful drafting of the agreement, expect to enforce an arbitration agreement under the FAA where they also specify any state's substantive law to govern their contract. Parties cannot do so because, according to the court in *Cronus*, California's section 1281.2(c) will supplant

the FAA's requirement that litigation be stayed in order that arbitration may proceed. Even more alarming is the fact that this outcome is to be expected even if the parties' contract *fails to mention California law* but, instead, specifies another state's substantive law.

The consequence of California's presumption of intent and its default to California arbitration rules essentially eviscerates the arbitration rights guaranteed by the FAA. At the very least, this Court should grant certiorari in order to establish whether the analysis being utilized by the California courts is a permissible method of contract interpretation under *Volt*. If so, parties engaged in interstate commerce then will know that the FAA is subordinate to California law and that, as a result, arbitration agreements cannot be enforced if the terms of section 1281.2(c) are satisfied.

## CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted and the decisions below reversed.

Dated this 15th day of September, 2005.

Respectfully submitted by:

KERRY L. KESTER
*Counsel of Record*
JOEL D. HEUSINGER
KRISTA L. KESTER
WOODS & AITKEN, L.L.P.
SUITE 500
301 SOUTH 13TH STREET
LINCOLN, NE 68508-2578
(402) 437-8500

MICHAEL E. LONDON
MCINERNEY & DILLON, P.C.
ONE KAISER PLAZA
18TH FLOOR
OAKLAND, CA 94612
(510) 465-7100

Court of Appeal, First Appellate District,
Division Two – No. A097298
S120791

**IN THE SUPREME COURT OF CALIFORNIA**

**En Banc**

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THE REGENTS OF THE UNIVERSITY OF CALIFORNIA, Plaintiff and Respondent,

v.

SSW INC. et al., Defendants and Appellants.

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(Filed May 18, 2005)

In light of the decision in *Cronus Investments, Inc. v. Concierge Services* (2005) 35 Cal.4th 376, review in the above-entitled matter is dismissed. (Cal. Rules of Court, rule 29.3(b).)

George
*Chief Justice*

Kennard
*Associate Justice*

Baxter
*Associate Justice*

Werdegar
*Associate Justice*

Chin
*Associate Justice*

Brown
*Associate Justice*

Moreno
*Associate Justice*

Court of Appeal, First Appellate District, Division Two –
Nos. A097298/A096947
S120791

**IN THE SUPREME COURT OF CALIFORNIA**

**En Banc**

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THE REGENTS OF THE UNIVERSITY OF CALIFORNIA,
Plaintiff and Respondent,

v.

SSW INC. et al., Defendants and Appellants.

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(Filed Jan. 28, 2004)

Petition for review GRANTED.

Further action in this matter is deferred pending consideration and disposition of a related issue in *Cronus Investment Inc. v. Concierge Services LLC*, S116288 (see Cal. Rules of Court, rule 28.2(c), or pending further order of the court. Submission of additional briefing, pursuant to California Rules of Court, rule 29.1, is deferred pending further order of the court.

George, C.J., was absent and did not participate.

Werdegar
*Acting Chief Justice*

Kennard
*Associate Justice*

Baxter
*Associate Justice*

*Associate Justice*

Chin
*Associate Justice*

Brown
*Associate Justice*

Moreno
*Associate Justice*

**NOT TO BE PUBLISHED IN OFFICIAL REPORTS**



IN THE COURT OF APPEAL
OF THE STATE OF CALIFORNIA
FIRST APPELLATE DISTRICT
DIVISION TWO

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|---|---|
| THE REGENTS OF THE UNIVERSITY OF CALIFORNIA,<br>Plaintiff and Respondent,<br>v.<br>SSW, INC. et al.,<br>Defendants and Appellants. | A097298, A096947<br>(San Francisco County Super. Ct. No. 304352) |

## INTRODUCTION

(Filed Oct. 24, 2003)

Tuthill Corporation (Tuthill) and SSW, Inc. (SSW) appeal from an order of the San Francisco Superior Court denying their petitions to compel arbitration of claims filed against them by the Regents of the University of California (Regents). The trial court denied the petitions under Code of Civil Procedure section 1281.2, subdivision (c)[1]

[1] All statutory references are to the Code of Civil Procedure unless otherwise indicated.

(hereafter section 1281.2(c)), which allows the court to stay arbitration pending resolution of related litigations where there is a possibility of conflicting rulings and contradictory judgments. The court ruled that the contracting parties had agreed that their arbitration agreement would be governed and enforced by California law (including section 1281.2(c)) and that the Federal Arbitration Act (9 U.S.C. § 1 et seq.) (FAA) did not preempt that state statute.

Tuthill and SSW contend that provisions of their contracts – and particularly the choice-of-law provisions – do not demonstrate an intention to make the contracts subject to section 1281.2(c). Consequently, they argue that the California statute is preempted by the FAA and that the FAA requires enforcement of the arbitration agreement despite the potential for conflicting results. We shall affirm the order.

## Facts and Procedural Background

In early 1994, the Regents contracted with Walsh Construction Company (Walsh) for construction and renovation of the Parnassus Central Utilities Plant at the University of California at San Francisco. Tuthill and SSW[2] are out-of-state corporations who were subcontractors for the design and construction of heat recovery steam generators, the steam turbine generator, and auxiliary boilers on the cogeneration power plant project. After the project was underway, Walsh's parent company filed for bankruptcy. Project sureties, Fidelity and Deposit Company of Maryland and Universal Underwriters Insurance

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[2] SSW obtained or assumed the assets and liabilities of its predecessor National Dynamics Corporation on June 23, 1998. For ease of reference, SSW shall refer either to SSW or to its predecessor National Dynamics.

Company, took assignment of Walsh's obligations and rights under Walsh's contract with the Regents. In June 1999 the Regents filed suit against the sureties to recover on the performance bond and alleged that Walsh had failed to fulfill its obligations on the project. On June 8, 2001, the Regents amended their original complaint to include causes of action against Tuthill and SSW based upon the Regents' status as a third party beneficiary to the Walsh subcontracts and alleging numerous defects and inadequate construction in the equipment designed, built, or supplied by Tuthill and SSW.

The subcontracts between Walsh and Tuthill and Walsh and SSW contained identical choice-of-law provisions:

"*Governing laws.* This Contract Order shall be governed by, construed, and enforced in accordance with the laws of the State of California, exclusive of conflicts by laws provisions."

The arbitration provisions of the subcontracts were also identical and provided:

"*Arbitration*: If the forgoing procedures do not resolve the dispute, the dispute shall be decided by arbitration in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association then prevailing as supplemented by Sections 1282.6, 1283 and 1283.05 of the California Code of Civil Procedure, unless the parties mutually agree otherwise. Selection of arbitrators shall be in accordance with rules of the American Arbitration Association. The Arbitrator(s) shall be bound by, and apply California law. Each party hereto expresses consent and agrees that any arbitration arising of or relating to this Agreement, or the breach thereof, may, at the option of either party, include by consolidation, joinder

or in any other manner, other persons involved in or affected by such claim, dispute or other matter. . . . The forgoing agreement to arbitrate . . . shall be specifically enforceable under the prevailing Arbitration Law. The award rendered by the Arbitrators shall be final, and judgment may be entered upon it in accordance with applicable law in any court having jurisdiction thereof. All arbitration proceedings hereunder shall, unless all parties hereto otherwise agree, be conducted in the County of San Francisco."

The prime contract between the Regents and Walsh did not contain a mandatory arbitration provision.

Tuthill and SSW filed demurrers and petitions to compel arbitration. The Regents opposed the petitions to compel arbitration on the ground that the court should exercise the discretion afforded it under section 1281.2(c) to refuse to compel arbitration because of the potential for inconsistent rulings if the controversy were adjudicated in multiple forums. Tuthill and SSW responded that the FAA, which gives the court no discretion to deny arbitration on such grounds, preempted section 1281.2(c). After briefing and hearing before the Honorable Stuart Pollak, the court denied the demurrers and the petitions to compel arbitration. The court ruled that *Volt Info. Sciences v. Leland Stanford Jr. U.* (1989) 489 U.S. 468, (*Volt*) controlled. Accordingly, the court found that the parties to the arbitration agreements had agreed that the subcontracts not only would be "governed" by California law, but would be "enforced" in accordance with California law, including

section 1281.2(c), and the FAA did not preempt California law.[3]

Tuthill and SSW filed timely appeals to the court's order denying their petitions to compel arbitration.[4] On April 15, 2002, we granted the Regents' motion to consolidate the two appeals. After briefing was complete, the parties requested that we defer disposition of the appeal pending settlement. In May 2003, having been notified of the failure of settlement negotiations, we returned the case to the regular calendar.

## Discussion

"Congress passed the FAA 'to overcome courts' refusals to enforce agreements to arbitrate.' [Citations.]"

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[3] In his order denying the petitions to arbitrate, Judge Pollak reasoned:

"The Petitions to Compel Arbitration by SSW, Inc. and Tuthill Corporation are DENIED. The rule enunciated in *Volt Information Sciences v. Board of Trustees* (1989) 489 U.S. 468 is still controlling, and has been reaffirmed in the most recent decisions cited by the moving parties. (*E.g., Hyundai America, Inc. v. Meissner & Wurst GMBH & Co.* (1998) 26 F.Supp.2d 1217, 1219 ('The *Volt* Court held that the FAA did not preempt the California Arbitration Act's provision allowing a court to stay arbitration pending resolution of related litigation where the parties had agreed that their arbitration agreement would be governed by California law'). [ ] None of the other cases cited by the parties are to the contrary. In the present case, the controlling contract explicitly specifies not only that it shall be governed by California law, but that it will be 'enforced in accordance with the laws of the State of California.' In this critical respect, the contract provision differs from the contract language in *Warren-Guthrie v. Health Net* (2000) 84 Cal.App.4th 804. Since the subcontract is governed by California law, CCP section 1281.2(c) applies, and is not preempted."

[4] An order dismissing a petition to compel arbitration is appealable pursuant to section 1294.

(*Mastrobuono v. Shearson Lehman Hutton, Inc.* (1995) 514 U.S. 52, 55 (*Mastrobuono*); see also, *Volt, supra,* at p. 474.) The federal statute was intended to place arbitration agreements "'upon the same footing as other contracts. . . .'" (*Scherk v. Alberto-Culver Co.* (1974) 417 U.S. 506, 511. As explained in *Southland Corp. v. Keating* (1984) 465 U.S. 1, "the FAA not only 'declared a national policy favoring arbitration,' but actually 'withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.' 465 U.S., at 10." (*Mastrobuono, supra,* at p. 1216.) "State laws that apply to contracts generally can be applied to arbitration agreements, but '[c]ourts may not . . . invalidate arbitration agreements under state laws applicable *only* to arbitration provisions.' (*Doctor's Associates, Inc. v. Casarotto* (1996) 517 U.S. 681, 687)" (*Mount Diablo Medical Center v. Health Net of California, Inc.* (2002) 101 Cal.App.4th 711, 718 (*Mount Diablo*).)

"Section 1281.2(c) authorizes the court to refuse to enforce a contractual arbitration provision if arbitration threatens to produce a result that may conflict with the outcome of related litigation not subject to arbitration." (*Mount Diablo, supra,* at p. 717)[6] The FAA contains no

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[6] Section 1281.2 provides that on petition of a party to an arbitration agreement, the court shall order the parties to arbitrate the controversy "unless it determines that. . . . [¶] . . . [¶] (c) A party to the arbitration agreement is also a party to a pending court action . . . with a third party, arising out of the same transaction or series of related transactions and there is a possibility of conflicting rulings on a common issue of law or fact," in which case "the court (1) may refuse to enforce the arbitration agreement and may order intervention or joinder of all parties in a single action . . .; (2) may order intervention or joinder as to all or only certain issues; (3) may order arbitration

(Continued on following page)

similar provision. Nevertheless, in *Volt, supra,* 489 U.S. 468 (*Volt*), the United States Supreme Court held that application of section 1281.2(c) is not pre-empted by the FAA in cases "where the parties have agreed that their arbitration agreement will be governed by the law of California." (*Volt, supra,* at p. 470; see also *Mastrobuono, supra,* at p. 57.)

The *Volt* Court recognized that the primary purpose of the FAA is to "ensure[ ] that private agreements to arbitrate are enforced according to their terms. Arbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit. Just as they may limit by contract the issues which they will arbitrate [citation], so too may they specify by contract the rules under which that arbitration will be conducted. Where . . . the parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA, even if the result is that the arbitration is stayed where the Act would otherwise permit it to go forward." (*Id.* at p. 479.)

Following *Volt,* California courts examine the underlying contract containing the arbitration clause to determine whether the parties have agreed to application of section 1281.2(c) to their agreement. (*Mount Diablo, supra,* at p. 717; *Warren-Guthrie v. Health Net* (2000) 84 Cal.App.4th 804, 808.) Consequently, the key issue in this case is whether, by the choice-of-law and arbitration provisions of

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among the parties who have agreed to arbitration and stay the pending court action . . . pending the outcome of the arbitration proceeding; or (4) may stay arbitration pending the outcome of the court action. . . ."

the subcontracts, the parties agreed to application of section 1281.2(c). This issue presents a question of law subject to de novo review by this court. (*Mount Diablo, supra,* at p. 717; *Warren-Guthrie v. Health Net, supra,* at p. 814; *24 Hour Fitness, Inc. v. Superior Court* (1998) 66 Cal.App.4th 1199, 1212.)

The particular choice-of-law clause involved in *Volt* provided that "'[t]he Contract shall be governed by the law of the place where the Project is located.'" (*Id.* at p. 470.) The California Court of Appeal concluded that by this choice-of-law provision "the parties had incorporated the California rules of arbitration, including § 1281.2(c), into their arbitration agreement." (*Volt, supra,* at p. 472.) "The Supreme Court held that the parties had thereby 'agreed that arbitration would not proceed in situations which fell within the scope of [section 1281.2(c)]' (*Volt, supra,* at p. 475) and that the FAA did not prevent application of this provision to stay the arbitration. (*Id.* at p. 477.) '[A]pplication of the California statute is not pre-empted by the [FAA] in a case where the parties have agreed that their arbitration agreement will be governed by the law of California.' (*Id.* at p. 470.)" (*Mount Diablo, supra,* at p. 719.)

The Regents contend, and the trial court agreed, that *Volt* controls. Tuthill and SSW counter that the Supreme Court in *Volt* did not itself determine whether the state appellate court's construction of the choice-of-law provision in the contract was correct, but considered itself bound to accept that court's interpretation of the contract. (See *Volt, supra,* at p. 474.) Tuthill and SSW rely instead upon the later-decided *Mastrobuono, supra,* 514 U.S. 52 and upon federal cases that have followed it, contending that the use of a "generic" choice-of-law provision does not evince an

intent by the parties to choose California arbitration law in preference to federal arbitration law. Building upon *Mastrobuono*, Tuthill and SSW contend that the arbitration clause and choice-of-law clause in the subcontracts here did not incorporate section 1281.2(c); that section 1281.2(c) cannot be used to delay or avoid arbitration of a contract dispute governed by the FAA; and that any interpretation of the subcontracts to incorporate section 1281.2(c) results in ambiguity that must be resolved in favor of arbitration.

*Mastrobuono* involved interpretation of a standard-form contract between a securities brokerage firm and its customers requiring arbitration, but which expressly provided that "it 'shall be governed by the laws of the State of New York,' . . . " (*Id.* at p. 53.) New York law allowed courts, but not arbitrators, to award punitive damages. A panel of arbitrators awarded punitive damages. A federal district court and federal Court of Appeals disallowed the punitive damages award. The Supreme Court reversed, citing *Volt*. The choice-of-law provision could reasonably be read in isolation to be "merely a substitute for the conflict-of-laws analysis that otherwise would determine what law to apply to disputes arising out of the contractual relationship" (*id.* at p. 59) and New York law would be pre-empted by the FAA because the provision did not show the parties' intention to preclude the award of punitive damages by arbitrators. The clause might also be read to "include only New York's substantive rights and obligations, and not the State's allocation of power between alternative tribunals." (*Id.* at p. 60.) Consequently, the court concluded the clause was "not, in itself, an unequivocal exclusion of punitive damages claims." (*Ibid.*) Rejecting a broader reading of the clause,

the court refused to defer to the lower courts' interpretation of the contract. *Mastrobuono* distinguished *Volt*, in which the Supreme Court "deferred to the California court's construction of its own States law" on the grounds that, in *Mastrobuono*, it was reviewing a lower *federal* court's interpretation of the contract and the only deference arguably called for was to the arbitrator. (*Mastrobuono, supra*, at p. 60, fn. 4.) The *Mastrobuono* majority then contrasted the choice-of-law provision with the arbitration provision which authorized arbitration in accordance with NASD rules, and "strongly implie[d]" that arbitrators might appropriately award punitive damages. (*Id.* at pp. 60-61.) The court reasoned that the choice-of-law clause at most, "introduces an ambiguity into an arbitration agreement that would otherwise allow punitive damages. As we pointed out in *Volt*, when a court interprets such provisions in an agreement covered by the FAA, 'due regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the arbitration clause itself resolved in favor of arbitration.' 489 U.S., at 476. . . ." (*Id* . at p. 62.) Finally, the court concluded the "best way to harmonize the choice-of-law provision with the arbitration provision is to read 'the laws of the State of New York' to encompass substantive principles that New York courts would apply, but not to include special rules limiting the authority of arbitrators. Thus, the choice-of-law provision covers the rights and duties of the parties, while the arbitration clause covers arbitration; neither sentence intrudes upon the other. In contrast, respondents' reading sets up the two clauses in conflict with another: one foreclosing punitive damages, the other allowing them. This interpretation is untenable." (*Id.* at pp. 63-64.)

Considering itself "bound by *Mastrobuono,*" the Ninth Circuit in *Wolsey, Ltd. v. Foodmaker, Inc.* (9th Cir.1998) 144 F.3d 1205 (*Wolsey*), held that a choice-of-law clause providing that "'[t]his Agreement . . . shall be interpreted and construed under the laws of the State of California, U.S.A.'" did not incorporate section 1281.2(c). (*Id.* at p. 1213.) *Wolsey* read *Mastrobuono* as dictating that generic choice-of-law clauses do not incorporate state procedural rules governing the allocation of authority between courts and arbitrators. (*Wolsey, supra,* at pp. 1212-1213.) It determined the choice-of-law clause before it was "general" and did not contain a specific reference to the state arbitration rule at issue. (*Id.* at p. 1212.) Therefore, it proceeded to determine "whether section 1281.2(c) is a 'substantive principle that [California] courts would apply' or is instead 'a special rule[ ] limiting the authority of arbitrators.'" (*Ibid.*) *Wolsey* concluded that section 1281.2(c) did not affect "'only [California's] substantive rights and obligations,'" but affects [California's] allocation of power between alternative tribunals.' [Citation.] It therefore reversed the district court's refusal to compel arbitration. (*Id.* at p. 1213.)

In *Mount Diablo, supra,* 101 Cal.App.4th 711, an opinion published after briefing was completed in this case, another division of this court wrestled with "'the thorny question of contract construction raised by the generic choice-of-law clause' in an agreement calling for the resolution of disputes by arbitration.[6]" (*Id.* at p. 714.)

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[6] "Note, *An Unnecessary Choice of Law: Volt, Mastrobuono, and Federal Arbitration Act Preemption* (2002) 115 Harv.L.Rev. 2250, 2251. . . .)"

In a comprehensive[7] and thoughtful opinion, former Judge, now Justice Pollak, distinguished *Mastrobuono* and disagreed "with the implicit determination in *Wolsey* that section 1281.2(c) is '"a special rule[ ] limiting the authority of arbitrators"' [citation], as was the New York rule involved in *Mastrobuono*." (*Mount Diablo, supra,* at p. 725.) Justice Pollak explained that "[t]his view contradicts the characterization of section 1281.2(c) by the Supreme Court itself not only in *Volt*. . . . (*Volt, supra,* 489 U.S. at p. 476, fn. 5) but in the subsequent decision in *Doctor's Associates, Inc. v. Casarotto, supra,* 517 U.S. 681. In rejecting a Montana statute requiring arbitration agreements to contain a particular form of notice in order to be enforceable, the Supreme Court contrasted that statute with section 1281.2(c): 'The state rule examined in *Volt* determined only the efficient order of proceedings; it did not affect the enforceability of the arbitration agreement itself. We held that applying the state rule would not "undermine the goals and policies of the FAA," [citation], because the very purpose of the Act was to "ensur[e] that private agreements to arbitrate are enforced according to their terms.' (517 U.S. at p. 688; [citation].)" (*Mount Diablo, supra,* at pp. 725-726.)

*Mount Diablo* rebuffed the attempt to lump all choice-of-law clauses that do not explicitly reference arbitration under the rubric "generic," recognizing that "the term has no precise definition" and pointing out that if such "generic" provision were insufficient to incorporate state law

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[7] Observing that [t]he decisions in *Volt* and *Mastrobuono* have given rise to a good bit of commentary as well as criticism" (*id.* at p. 720), the *Mount Diablo* opinion canvasses that commentary. (*Id.* at pp. 720-721, and fn. 7)

regarding the enforcement of arbitration agreements without further elaborating the specific provisions of state law to which it applies, such a redundancy would also logically be required of other provisions incorporated by choice-of-law clauses, "e.g., provisions treating indemnification rights or termination events in contracts involving the interstate transportation of products.' [Citation.]" (*Id.* at p. 722.)

Therefore, *Mount Diablo* rejected a "'default rule' that 'a generic choice-of-law clause, standing alone, is insufficient to support a finding that contracting parties intended to opt out of the FAA's default standards.' [Citation.]" (*Id.* at p. 721.) Rather than requiring "'extrinsic evidence of the parties' intent to contract out of the FAA's default regime'" or an express reference to particular state statutes which the parties intend to incorporate into their agreement, *Mount Diablo* followed the traditional approach of attempting to discern the intention of the parties from the language of the agreement, affirming that the "starting point in the interpretation of the choice-of-law clause, like any contractual provision, is with the language of the contract itself." (*Id.* at p. 722.) In undertaking to discern the parties' intentions from the language of the agreements, the *Mount Diablo* court "agree[d] with the observation of the concurring judge in *Roadway Package* [*System, Inc. v. Kayser* (3d Cir.2001) 257 F.3d 287, cert. den.], . . . that '[t]he choice-of-law almost invariably is meant to encompass the entire agreement' (*id.* at p. 308.)" (*Id.* at p. 722.)

The broad choice-of-law clause in *Mount Diablo* provided that "'[t]he validity, construction, interpretation *and enforcement* of this Agreement' shall be governed by California law." (*Id.* at p. 722 italics added.) Although the

clause was "generic" in the sense that it does not mention arbitration or any other specific issue that might become a subject of controversy" (*id.* at p. 722), it was "nonetheless broad, unqualified and all encompassing. . . . The explicit reference to enforcement reasonably includes such matters as whether proceedings to enforce the agreement shall occur in court or before an arbitrator." (*Id.* at p. 722.) Moreover, only a "strained" reading of this broad choice-of-law provision could exclude reference to the chapter in which section 1281.2 appears, Chapter 2 of title 9 of part III of the Code of Civil Procedure, titled "Enforcement of Arbitration Agreements." (*Ibid.*)

*Mount Diablo* contrasted this broad and unqualified provision with the choice-of-law provision of the agreement in *Mastrobuono,* which provided only that it '"shall be governed by the laws of the State of New York."' [Citation.]" (*Mount Diablo, supra,* at p. 723.) *Mount Diablo* also contrasted the choice-of-law provision in the agreement before it with that interpreted by the California appellate court in *Warren-Guthrie v. Health Net, supra,* 84 Cal.App.4th 804 (*Warren-Guthrie*), providing only that "[a]ll Arbitration shall be *conducted* in accordance with the California Code of Civil Procedure, commencing with Section 1280." (*Id.* at p. 815, italics added; *Mount Diablo, supra,* at p. 723.)

Based on the narrow language of that choice-of-law clause, *Warren-Guthrie* concluded that the parties had not agreed that the *enforceability* of the arbitration agreement would be determined by California law. (*Warren-Guthrie* at pp. 815-816.) While reaffirming *Volt's* holding that a petition to compel arbitration may be denied pursuant to section 1281.2, where the parties have agreed to application of California law for this purpose, *Warren-Guthrie*

focused upon the use of the term "conducted" in the narrow choice-of-law provision before it, reasoning: "There is no express language indicating that California law shall be determinative as to whether or not arbitration is required. Unlike in *Volt*, the parties did not agree that California law shall apply for all purposes. Rather, the agreement limits application of California law to California contractual arbitration law, and further limits the scope of California law to that pertaining to the manner in which the arbitration is to be conducted." (*Id.* at p. 815.) The "key term" of the choice-of-law provision was "*conducted*" (*ibid.*), leading *Warren-Guthrie* to conclude that "[a]greement to apply California contractual arbitration law is expressly limited to that law which bears on how the arbitration shall be conducted, as distinguished from agreeing the plan shall be governed by California law for all purposes, including the determination as whether or not arbitration is required. There being no such express language to the contrary, and in light of the overriding state and federal policy of enforcing privately negotiated agreements to arbitrate in accordance with their terms [citations]," the court concluded that the choice-of-law provision "does not allow nonarbitration based on the section 1281.2(c) exception to arbitration. [Citation.]" (*Id.*, at p. 816.)

In reconciling the disparate authorities, the *Mount Diablo* court emphasized the difference in language of the various choice-of-law clauses being construed, pointing out that several of the federal cases following *Mastrobuono* "contain choice-of-law provisions that use language similar to that in *Mastrobuono* and *Wolsey*, to the effect that the agreement would be governed by the law of a particular jurisdiction, without reference to enforcement.

[Citations.]" (*Id.* at p. 723.) The significance of this difference in language was recognized in *Warren-Guthrie, supra,* and by the Court of Appeals of New York in *Smith Barney, etc. v. Luckie* (1995) 85 N.Y.2d 193.) (*Id.* at p. 724 [language that New York law governs the agreement *and its enforcement* indicates intent to arbitrate to the extent allowed by New York law, even if application of state law would relieve parties of their responsibility under the contract to arbitrate].) (*Mount Diablo, supra,* at p. 724.)

Having determined that the language of the choice-of-law clause before it was "unquestionably" "broad enough to include state law on the subject of arbitrability," *Mount Diablo* proceeded to analyze "whether the particular provision of state law in question is one that reflects a hostility to the enforcement of arbitration agreements that the FAA was designed to overcome. If so, the choice-of-law clause should not be construed to incorporate such a provision, at least in the absence of unambiguous language in the contract making the intention to do so unmistakably clear. In *Mastrobuono* itself, the state law in question would have denied an arbitrator the ability to award the same relief as a court, and the Supreme Court held that the ambiguity in the contract should be resolved by reading the choice-of-law clause 'not to include special rules limiting the authority of arbitrators.' (*Mastrobuono, supra,* 514 U.S. at p. 64. . . .)" (*Id.* at p. 724.) Cases concluding application of state law would contravene the FAA, often involved state rules, like the New York rule in *Mastrobuono,* that "tended to restrict rather than to facilitate the use of arbitration. . . ." (*Id.* at p. 725.) In contrast, "where the state arbitration provision is not inconsistent with the FAA policy of enforcing arbitration procedures chosen by the parties, choice-of-law clauses

making no explicit reference to arbitration commonly have been interpreted to incorporate the state's law governing the enforcement of arbitration agreements. [Citations.]" (*Id.* at p. 725.)

*Mount Diablo* recognized that section 1281.2(c) is "part of California's statutory scheme designed to enforce the parties' arbitration agreements, as the FAA requires. Section 1281.2(c) addresses the peculiar situation that arises when a controversy also affects claims by or against other parties not bound by the arbitration agreement. The California provision giving the court discretion not to enforce the arbitration agreement under such circumstances – in order to avoid potential inconsistency in outcome as well as duplication of effort – does not contravene the letter or the spirit of the FAA. That was the explicit holding in *Volt* and nothing in *Mastrobuono* casts doubt on that conclusion." (*Id.* at p. 726.) *Mount Diablo* therefore concluded that section 1281.2(c) was not designed to discourage the use of arbitration or to limit the rights of parties choosing to arbitrate. (*Ibid.*)

Having determined that the language of the choice-of-law provision was broad enough to incorporate section 1281.2(c) and that the statute did not reflect a hostility to the enforcement of arbitration agreements and was not inconsistent with the FAA policy of enforcing arbitration procedures chosen by the parties, *Mount Diablo* affirmed the superior court order denying the petition to compel arbitration. (*Id.* at pp. 724-727.)

The choice-of-law clause in the case before us is of similar breadth to that interpreted in *Mount Diablo*, providing that the contract "shall be *governed by*, construed, *and enforced* in accordance with the laws of the

State of California, exclusive of conflicts by laws provisions." (Italics added.) We agree with *Mount Diablo*, that such broad language – particularly use of the term "enforced" evinces the intention of the parties to apply California law (including section 1281.2(c)) to enforcement of the agreement.

Nothing in the arbitration clause itself is inconsistent with our reading of the choice-of-law clause presented here. Tuthill and SSW contend that the specific references to other sections of California's arbitration law, specifically sections 1282.6 [issuance of subpoenas], 1283 [depositions], and 1283.05 [manner of taking depositions], demonstrate an intent to exclude other provisions not specifically mentioned, including section 1281.2(c). We disagree. These particular code sections are included in the arbitration clause itself, which sets forth the rules by which the arbitration is to be conducted. That clause provides for arbitration in accordance "with the Construction Industry Arbitration Rules of the American Arbitration Association then prevailing as supplemented by sections 1282.6, 1283 and 1283.05. . . ." Specifying the particular rules under which the arbitration is to be *conducted* does not conflict with the parties' choice of California law to govern how the agreement is *enforced*. (*See Warren-Guthrie, supra*, at p. 815; *Mount Diablo, supra*, at pp. 723-724.) The subcontracts clearly require that they be "enforced" according to California law and we construe them to incorporate section 1281.2(c). Nothing in the arbitration provision or any other provision of the subcontracts conflicts with this choice-of-law or creates an "ambiguity" which must be resolved in favor of FAA preemption of section 1281.2(c). (*See Moses H. Cone Hospital v. Mercury Constr. Corp.* (1983) 460 U.S. 1, 24-25.)

Nor do we find *Mastrobuono* requires a different result. As *Mount Diablo* explains, the circumstances in that case were very different from those involved in the present case. The choice-of-law clause at issue in *Mastrobuono* was considerably narrower than that present here. Moreover, the New York arbitration law at issue in *Mastrobuono* "would have denied an arbitrator the ability to award the same relief as a court" in contravention of the FAA and it tended to restrict the use of arbitration. In contrast, section 1281.2(c) is not inimical to or discouraging of arbitration, but rather "is part of California's statutory scheme designed to enforce the parties' arbitration agreements, as the FAA requires." (*Mount Diablo, supra,* at p. 726.) The statute addresses a particular problem arising in when an arbitrable controversy affects claims by or against others not bound by the arbitration agreement. By giving the trial court discretion not to compel arbitration in order to avoid potential inconsistency in outcome and duplication of effort, section 1281.2(c) contravenes neither the letter nor the spirit of the FAA. (*Mount Diablo, supra,* at p. 726.)

SSW relies extensively upon *Energy Group, Inc. v. Liddington* (1987) 192 Cal.App.3d 1520 which held that section 1281.2(c) applied only to contracts subject to arbitration and was therefore preempted by the FAA to the extent it was used to avoid or delay arbitration. (*Id.* at pp. 1522, 1528.) The case predates *Volt* and the court did not undertake to interpret the contract to determine whether the parties intended to incorporate section 1281.2(c) *Volt, Mastrobuono,* and subsequent cases have rendered its analysis obsolete. We agree with the analysis of *Mount Diablo* and reiterate the observation of the Supreme Court in *Volt* that California's arbitration laws generally foster

the goals of the FAA and that "California has taken the lead in fashioning a legislative response to this problem [of multiparty contractual disputes leading to potentially inconsistent rulings and contradictory judgments]. . . ." (*Volt, supra,* 489 U.S. at p. 476, fn. 5.) Insofar as *Warren-Guthrie, supra,* and *Energy Group, Inc. v. Liddington, supra,* could be viewed as supporting the proposition that the FAA bars the operation of section 1281.2(c) solely because it constitutes a special rule for arbitration, without examining the roots of the rule, we believe they were wrongly decided.

In summary, the subcontracts call for arbitration of disputes. By providing in a broad conflict-of-law clause that the contract "shall be governed by, construed, and enforced in accordance with the laws of the State of California, exclusive of conflicts by laws provisions," the parties to the subcontracts demonstrated an intention to incorporate section 1281.2(c) and thus agreed to allow a court to stay arbitration in situations falling within the scope of that statute. As the Supreme Court recognized in *Volt,* section 1281.2(c) is not hostile to the goals and policies of the FAA, and the FAA does not preempt the statute in these circumstances. (*Id.* at p. 1324.)

## Disposition

The order denying Tuthill and SSW's petition to compel arbitration is affirmed. Regents shall recover costs on appeal.

Kline, P.J.

We concur:

Haerle, J.

Lambden, J.

SUPERIOR COURT OF THE STATE OF CALIFORNIA
COUNTY OF SAN FRANCISCO
DEPARTMENT NUMBER 304

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| THE REGENTS OF THE UNIVERSITY OF CALIFORNIA, a California State agency,<br><br>Plaintiff,<br><br>vs.<br><br>FIDELITY AND DEPOSIT COMPANY OF MARYLAND, et al.,<br><br>Defendants. | NO. 304352<br><br>ORDER DENYING PETITIONS TO ARBITRATE<br><br>The Honorable Stuart R. Pollak<br><br>(Filed Oct. 15, 2001) |

The Petitions to Compel Arbitration by SSW, Inc. and Tuthill Corporation are DENIED. The rule enunciated in *Volt Information Sciences v. Board of Trustees* (1989) 489 U.S. 468 is still controlling, and has been reaffirmed in the more recent decisions cited by the moving parties. (*E.g.*, *Hundai America, Inc. v. Meissner & Wurst GMBH & Co.* (1998) 26 F.Supp. 2d 1217, 1219 ("The Volt Court held that the FAA did not preempt the California Arbitration Act's provision allowing a court to stay arbitration pending resolution of related litigation where the parties had agreed that their arbitration agreement would be governed by California law.")) None of the other cases cited by the moving parties are to the contrary. In the present case, the controlling contract explicitly specifies not only that it shall be governed by California law, but that it will be "enforced in accordance with the laws of the State of California." In this critical respect, the contract provision differs from the contract language in *Warren-Guthrie v.*

*Health Net* (2000) 84 Cal.App.4th 804. Since the subcontract is governed by California law, CCP section 1281.2(c) applies, and is not preempted.

Dated: 10/15/01 /s/ Stuart R. Pollak
STUART R. POLLAK
Judge of the Superior Court

IN THE SUPREME COURT OF CALIFORNIA

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| CRONUS INVESTMENTS, INC.,<br>Plaintiff, Cross-defendant and Appellant;<br>HOWARD JON COLMAN,<br>Cross-defendant and Appellant,<br>v.<br>CONCIERGE SERVICES,<br>Defendant, Cross-complainant and Respondents;<br>WESTREC MARINA MANAGEMENT, INC., et al.,<br>Defendants and Respondents. | S116288<br>Los Angeles County Super. Ct. No. LC060095<br>(Filed 3/10/05) |

Code of Civil Procedure section 1281.2, subdivision (c)[1] permits a trial court, under specified circumstances, to stay arbitration pending the outcome of related litigation. In *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.* (1989) 489 U.S. 468 (*Volt*), the United States Supreme Court held that the Federal Arbitration Act (FAA), 9 U.S. C. § 1 et. seq., which applies to and favors the enforcement of arbitration agreements affecting interstate commerce, does not preempt the application of section 1281.2, subdivision (c) where the parties had agreed that their arbitration agreement would be governed by the law of California. In this case, the

[1] Except as otherwise noted, all further statutory references are to the Code of Civil Procedure.

parties agreed that their arbitration agreement would be governed by California law, but they further agreed that the designation of California law "shall not be deemed an election to preclude application of the [FAA], if it would be applicable." As explained below, we conclude that, in this situation, the FAA also does not preempt the application of section 1281.2, subdivision (c).

## FACTS AND PROCEDURAL HISTORY

In July 2000, Howard Colman transferred a home-management business, Dew-All Services, Inc. (Dew-All), to a newly created company, Concierge Services, LLC (Concierge). Cronus Investments, Inc. (Cronus), which is wholly owned by Colman, has a 20 percent interest in Concierge, while Westrec Marina Management, Inc. (Westrec) owns the remaining interest. The transactions involved six agreements: (1) a limited liability company (LLC) agreement between Cronus and Westrec, which created Concierge; (2) a stock purchase agreement by which Concierge bought the stock in Colman's preexisting company, Dew-All; (3) an employment agreement by which Concierge employed Colman as its president; (4) a covenant not to compete and confidentiality agreement between Colman and Concierge; (5) a consulting agreement between Cronus and Concierge; and (6) a guaranty agreement executed by Westrec of a promissory note payable by Concierge to Colman.

Four of the six agreements provide for the arbitration of any disputes between the parties "arising out of, in connection with, or in relation to the interpretation,

performance or breach of this Agreement. . . ."[5] The arbitration clause further specifies that: "The designation of a situs or specifically a governing law for this agreement or the arbitration shall not be deemed an election to preclude application of the [FAA], if it would be applicable."[6] The agreements also contained a choice-of-law clause providing that: "[t]his agreement shall be construed and enforced in accordance with and governed by the laws of the State of California, without giving effect to the conflict of laws provisions thereof."

Problems arose after the execution of the agreements, resulting in Colman's discharge from his employment with Concierge. On March 19, 2002, Cronus sued Concierge, Westrec, Westrec Contracting, LLC (an affiliate of Westrec), Michael M. Sachs (chief executive officer of Westrec), and William W. Anderson and Michael P. Robbins

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[5] The LLC and guaranty agreements did not contain arbitration provisions.

[6] The arbitration clause read in full as follows:

"9.10. Arbitration

"(a) Agreement to Arbitrate. Any controversy, dispute or claim arising out of, in connection with, or in relation to the interpretation, performance or breach of this Agreement, including any claim based on contract, tort or statute, shall be settled, at the request of either party, by arbitration conducted in Los Angeles, California in accordance with the then existing Rules for Commercial Arbitration of the American Arbitration Association ('AAA'), and judgment upon any award rendered by the arbitrator may be entered by any State or Federal court having jurisdiction thereof. Any controversy concerning whether a dispute is an arbitrable dispute shall be determined by the arbitrator. The parties intend that this agreement to arbitrate be valid, specifically enforceable and irrevocable. The designation of a situs or specifically a governing law for this agreement or the arbitration shall not be deemed an election to preclude application of the [FAA], if it would be applicable."

(principals in Westrec). The complaint asserted claims for breach of contract, breach of fiduciary duty, conversion and fraud. After Cronus filed its complaint, Colman and Cronus submitted a demand for arbitration to the American Arbitration Association (AAA) under the arbitration clauses in the underlying agreements.

Concierge then filed a cross-complaint against Colman, Cronus, Nelson Colman (Colman's father), and Desert Home Services, Inc. (Desert), which is operated by Nelson Colman. The cross-complaint asserted claims for breach of contract, fiduciary fraud, unjust enrichment, and inducement of breach of contract. It alleged that Colman and Cronus improperly diverted business from Concierge to Colman's father and Desert.

Colman and Cronus then petitioned the superior court, under sections 1281.2 and 1281.4, to stay the litigation and compel arbitration, contending that they had already demanded arbitration and that some of the cross-claims implicated agreements containing an arbitration clause.

Defendants, in turn, moved to stay the arbitration pending the outcome of litigation and to consolidate the arbitration proceeding with the underlying action under section 1281.2, subdivision (c) (section 1281.2(c)). The trial court determined that: (1) some of the causes of action and controversies in the underlying action were not subject to arbitration; (2) only three of the eight cross-claims were arbitrable; (3) some of the litigants were not parties to agreements containing an arbitration agreement; and (4) the lawsuit and arbitration proceedings contained overlapping issues of fact and law. To avoid the possibility of contradictory outcomes and promote efficiency in the

resolution of disputes, the court denied the petition to stay litigation and compel arbitration, granted the motion to stay the arbitration proceedings pending outcome of the litigation, and consolidated the three arbitrable cross-claims with the action "for all purposes."

The Court of Appeal affirmed the trial court's ruling. First, as a matter of contract interpretation, the Court of Appeal found that the "not . . . preclude" language of the arbitration clause superseded the broader and more general choice-of-law provision and concluded that the parties intended that the FAA apply to the "fullest extent" and "without limitation" in those contracts containing arbitration agreements. Second, the Court of Appeal analogized a trial court's authority to stay arbitration proceedings (§ 1281.2(c)) to a court's authority to stay lawsuits when resolving problems of multiple litigation (§ 526, subd. (a)(6)) and found that section 1281.2(c) is a neutral law derived from equitable principles applicable to all contracts. The court thus determined that, because section 1281.2(c) on its face is "an evenhanded application of state principles addressing the general problem of multiple litigation," the FAA does not preempt its application.

In their petition for review, plaintiff Cronus and cross-defendant Colman (hereafter appellants) claim that the Court of Appeal erred in concluding that the FAA does not preempt the application of section 1281.2(c). Defendants (hereafter respondents) filed an answer to the petition, requesting that we determine whether the parties intended to incorporate section 1281.2(c) into the arbitration agreements and whether the FAA's procedural rules apply in California courts. Without limiting the issues, we

granted review to determine, in this case, whether the FAA preempts the application of section 1281.2(c).

## DISCUSSION

Section 1281.2(c) requires a court to order arbitration upon petition by one of the parties to an arbitration agreement, "unless [the court] determines that: [¶] . . . [¶] (c) A party to the arbitration agreement is also a party to a pending court action . . . with a third party, arising out of the same transaction or series of related transactions and there is a possibility of conflicting rulings on a common issue of law or fact." If the court makes such a determination, it:

"(1) may refuse to enforce the arbitration agreement and may order intervention or joinder of all parties in a single action . . . ; (2) may order intervention or joinder as to all or only certain issues; (3) may order arbitration among the parties who have agreed to arbitration and stay the pending court action . . . pending the outcome of the arbitration proceeding; or (4) may stay arbitration pending the outcome of the court action. . . ."

The parties do not dispute that this case comes within the exception to the general rule of arbitration enforcement specified in section 1281.2(c). Three of the 10 parties to the court action (Concierge, Colman, and Cronus) are parties to arbitrable agreements and the arbitration proceeding. But, the other seven parties to the court action (Westrec, Westrec Contracting, Sachs, Anderson, Robbins, Nelson Colman, and Desert) are not parties to any arbitration agreement and thus are not amenable to arbitration. None of the parties appear to dispute that many of the claims in the lawsuit are nonarbitrable. On the other

hand, the parties do dispute whether they intended that section 1281.2(c) procedures would govern the enforcement of those contracts that contain the arbitration provisions.

Under United States Supreme Court jurisprudence, we examine the language of the contract to determine whether the parties intended to apply the FAA to the exclusion of California procedural law and, if any ambiguity exists, to determine whether section 1281.2(c) conflicts with or frustrates the objectives of the FAA. We first examine the underlying purpose of and the rights created by the FAA and the applicable preemption principles.

**A. The FAA's Purpose**

In 1925, Congress passed the FAA to "overrule the judiciary's longstanding refusal to enforce agreements to arbitrate" and to place such agreements "'upon the same footing as other contracts, where it belongs.' [Citation.]" (*Dean Witter Reynolds Inc. v. Byrd* (1985) 470 U.S. 213, 219-220 (*Byrd*)). The federal statute rests on the authority of Congress to enact substantive rules under the commerce clause, requiring courts to enforce arbitration agreements in contracts involving interstate commerce. (*Southland Corp. v. Keating* (1984) 465 U.S. 1, 10-11 (*Keating*).) Here, the parties agree that the contracts at issue involve interstate commerce and, thus, fall within the coverage of the FAA.

Section 2, the primary substantive provision of the FAA, provides: "A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising . . . shall be valid, irrevocable, and

enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." (9 U.S.C. § 2.)

"Section 2 is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary. The effect of the section is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act." (*Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.* (1983) 460 U.S. 1, 24 (*Moses H. Cone*).) Thus, the FAA "establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." (*Moses H. Cone, supra*, 460 U.S. at pp. 24-25.) The policy of enforceability established by section 2 of the FAA is binding on state courts as well as federal courts. (*Rosenthal v. Great Western Fin. Securities Corp.* (1996) 14 Cal.4th 394, 405 (*Rosenthal*).)

However, the FAA's purpose is not to provide special status for arbitration agreements, but only "to make arbitration agreements as enforceable as other contracts, but not more so." (*Prima Paint Corp. v. Flood & Conklin Mfg. Co.* (1967) 388 U.S. 395, 404, fn. 12.) In accord with this purpose, the high court has stated that state contract rules generally govern the construction of arbitration agreements. (See, e.g., *Doctor's Associates, Inc. v. Casarotto* (1996) 517 U.S. 681, 685 (*Doctor's Associates*) ["'[s]tate law, whether of legislative or judicial origin, is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally'"]; *First Options of Chicago, Inc. v. Kaplan*

(1995) 514 U.S. 938, 944 [state law principles governing formation of contracts generally apply in deciding arbitrability issue]; *Allied-Bruce Terminix Cos. v. Dobson* (1995) 513 U.S. 265, 281 ["States may regulate contracts, including arbitration clauses, under general contract law principles. . . ."].) "[T]he federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate." (*Volt, supra,* 489 U.S. at p. 476.) Thus, the FAA does not force parties to arbitrate when they have not agreed to do so (see *Byrd, supra,* 470 U.S. at pp. 219-220) or require them to do so under any specific set of procedural rules (*Volt, supra,* 489 U.S. at pp. 476, 479). "Arbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit. Just as they may limit by contract the issues which they will arbitrate [citation], so too may they specify by contract the rules under which that arbitration will be conducted." (*Volt, supra,* 489 U.S. at p. 479.)

**B. Preemption**

"The FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration. [Citation.] But even when Congress has not completely displaced state regulation in an area, state law may nonetheless be pre-empted to the extent that it actually conflicts with federal law – that is, to the extent that it 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.' [Citation.]" (*Volt, supra,* 489 U.S. at p. 477.)

To ensure that arbitration agreements are enforced according to their terms, the FAA preempts all state laws that apply *of their own force* to limit those agreements against the parties' will or to withdraw the power to enforce them. (See, e.g., *Perry v. Thomas* (1987) 482 U.S. 483, 490-491 [FAA preempted California statute that rendered private agreements to arbitrate wage collection claims unenforceable by requiring judicial forum for resolution of those claims]; *Keating, supra*, 465 U.S. at p. 16 & fn. 10 [FAA preempted California statute that rendered agreements to arbitrate certain franchise claims unenforceable by requiring judicial forum for resolution of those claims].) Although state law may be applied to regulate contracts, including arbitration clauses, "'*if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally,' [citation]" courts may not invalidate arbitration agreements under state law contract principles applicable *only* to arbitration provisions, and that therefore disfavor such contracts, or single them out for "suspect status." (*Doctor's Associates, supra*, 517 U.S. at pp. 686-687.) For example, the high court found that a Montana statute that made arbitration clauses unenforceable unless the contract provided notice of the arbitration clause "'in underlined capital letters on the first page of the contract'" directly conflicted with the FAA; the state law conditioned the enforceability of arbitration agreements on a notice requirement not applicable to contracts generally. (*Doctor's Associates, supra*, 517 U.S. at pp. 684, 687-688.) Only "generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2" of the FAA. (*Doctor's Associates, supra*, 517 U.S. at p. 687.)

In addition, the FAA establishes a prophylactic rule governing ambiguities in arbitration clauses. Section 2 of the FAA (9 U.S.C. § 2), applicable to any arbitration agreement within the coverage of the Act, requires that "questions of arbitrability . . . be addressed with a healthy regard for the federal policy favoring arbitration." (*Moses H. Cone, supra*, 460 U.S. at p. 24.) Any doubts or ambiguities as to the scope of the arbitration clause itself should be resolved in favor of arbitration. (*Id.* at pp. 24-25; see also *Volt, supra*, 489 U.S. at pp. 475-476.)

## C. Volt

*Volt* involved the application of section 1281.2(c) to a lawsuit with interrelated arbitrable and nonarbitrable claims and parties who were not subject to the arbitration agreement at issue. The underlying contract, which covered the installation of an electrical system on the Stanford University campus, contained an agreement to arbitrate all disputes between the parties "'arising out of or relating to this contract or the breach thereof.'" The contract also contained a choice-of-law provision that the contract "'shall be governed by the law of the place where the Project is located,'" which was California. After disputes arose, Volt demanded arbitration. Stanford, in turn, filed an action in the California superior court against Volt and other companies involved in the construction project with whom it did not have arbitration agreements. The trial court, ruling on Stanford's motion to stay the arbitration and Volt's motion to compel arbitration and stay the lawsuit, stayed the arbitration under section 1281.2(c). (*Volt, supra*, 489 U.S. at pp. 470-471.)

The California Court of Appeal affirmed the trial court's ruling, concluding that the choice-of-law provision incorporated California's rules of arbitration into the contract. (*Volt, supra,* 489 U.S. at pp. 471-472.) After acknowledging that "the interpretation of private contracts is ordinarily a question of state law, which this Court does not sit to review," the high court accepted the Court of Appeal's construction that the choice-of-law provision incorporated the state arbitration laws, including section 1281.2(c). (*Volt, supra,* 489 U.S. at pp. 474-476.) The court held that application of the California statute to stay arbitration would not undermine the goals and policies of and is not preempted by the FAA in a case where the parties have agreed that their arbitration agreement will be governed by the law of California. (*Volt, supra,* 489 U.S. at pp. 470, 477-479.) "There is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate." (*Id.* at p. 476.)

### D. The Choice-of-law and Arbitration Clauses in This Case

In this case, the choice-of-law clause provides that: "[t]his agreement shall be construed and enforced in accordance with and governed by the laws of the State of California, without giving effect to the conflict of laws provisions thereof." The parties seem to agree that the broad choice-of-law provision generally incorporates California law, including the California Arbitration Act (CAA) (§ 1280 et. seq.), of which section 1281.2(c) is a part.

*Mount Diablo Medical Center v. Health Net of California, Inc.* (2002) 101 Cal.App.4th 711 (*Mount Diablo*) – in which the choice-of-law provision was similar to the one here – supports their interpretation. There, the court stated: "The choice-of-law provision in the present case may be 'generic' in the sense that it does not mention arbitration or any other specific issue that might become a subject of controversy, but it is nonetheless broad, unqualified and all-encompassing. It provides that 'the validity, construction, interpretation and enforcement of this Agreement' shall be governed by California law. The explicit reference to enforcement reasonably includes such matters as whether proceedings to enforce the agreement shall occur in court or before an arbitrator. Chapter 2 (in which § 1281.2 appears) of title 9 of part III of the California Code of Civil Procedure is captioned 'Enforcement of Arbitration Agreements.' An interpretation of the choice-of-law provision to exclude reference to this chapter would be strained at best." (*Mount Diablo, supra,* 101 Cal.App.4th at p. 722.)

Thus, we agree that the choice-of-law provision – which is substantially similar to the provisions in *Mount Diablo* and *Volt* – incorporates California's rules of arbitration into the contract. However, the contracts at issue in *Mount Diablo* and *Volt* did not contain the arbitration clause here, which states: "The designation of a situs or specifically a governing law for this agreement or the arbitration shall not be deemed an election to preclude application of the [FAA], if it would be applicable." The parties agree that, as specified in the arbitration clause, the scope of the choice of law provision is "specifically limited by applicable provisions of the FAA" and is nullified "only where the FAA's provisions are inconsistent with

the CAA." Respondents contend that the procedural rules of section 1281.2(c) do not conflict with the FAA's procedural provisions – because they do not apply in state court – or with its substantive provision (9 U.S.C. § 2). Appellants respond that we need not determine whether section 1281.2(c) conflicts with the procedural provisions of the FAA because application of section 1281.2(c) would, nevertheless, contravene the substantive goals and policies of the FAA. Because we disagree with appellant's premise, we first decide whether the procedural provisions of the FAA conflict with section 1281.2(c).

Section 3 of the FAA concerns the enforcement of arbitration agreements in a pending lawsuit. It requires the "courts of the United States" to grant a party's request for a stay of litigation on an arbitrable issue, pending completion of the arbitration. (9 U.S.C. § 3.)[4] Section 4 of the FAA concerns petitions for enforcement of an arbitration agreement where one party refuses to arbitrate. It requires a "United States district court" to entertain an application to compel arbitration. (9 U.S.C. § 4.)[5]

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[4] Section 3 of the FAA states: "If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration."

[5] Section 4 of the FAA states: "A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising

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The language used in sections 3 and 4 and the legislative history of the FAA suggest that the sections were intended to apply only in federal court proceedings. Section 4 refers to the "United States district court" and provides that it can be invoked only in a court that has jurisdiction under title 28 of the United States Code. (9 U.S.C. § 4.) This language indicates that Congress intended to limit the application of the section to federal courts. "In 1954, as a purely clerical change, Congress inserted 'United States district court' in § 4 as a substitute for 'court of the United States.' [Act of Sept. 3, 1954, ch.

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out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall make an order referring the issue or issues to a jury in the manner provided by the Federal Rules of Civil Procedure, or may specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof."

1263, § 19, 68 Stat. 1226, 1233.] Both House and Senate Reports explained: '"United States district court" was substituted for "court of the United States" because, among Federal courts, such a proceeding would be brought only in a district court.' H.R.Rep. No. 1981, 83d Cong., 2d Sess., 8 (1954); S.Rep. No. 2498, 83d Cong., 2d Sess., 9 (1954)." (*Keating, supra,* 465 U.S. at p. 29, fn. 18 (dis. opn. of O'Connor, J.).)

Although 9 United States Code section 3 is less clear, it would appear that "courts of the United States" under section 3 means federal district courts, because state courts are courts "in" but not "of" the United States as commonly designated in federal law. (*Keating, supra,* 465 U.S. at p. 29, fn. 18 (dis. opn. of O'Connor, J.).) Because sections 3 and 4 constitute part of the same enforcement scheme under the FAA, the language in both sections should be interpreted consistently. (*Keating, supra,* 465 U.S. at p. 29, fn. 17 (dis. opn. of O'Connor, J.) ["§ 3 applies when the party resisting arbitration initiates the federal-court action; § 4 applies to actions initiated by the party seeking to enforce an arbitration provision"].) Moreover, before the minor amendment in section 4's phrasing, "[a]s originally enacted, § 3 referred, in the same terms as § 4, to 'courts [or court] of the United States.'" (*Keating, supra,* 465 U.S. at p. 29 (dis. opn. of O'Connor, J.).) The legislative history of the original enactment further suggests that sections 3 and 4 were intended to regulate federal procedures for the enforcement of arbitration agreements.[6]

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[6] The House of Representatives' report on the FAA noted: "'This bill declares simply that such agreements for arbitration shall be enforced, and provides a procedure in the Federal courts for their enforcement.' H.R.Rep. No. 96, 68th Cong., 1st Sess., 1-2 (1924)." (*Byrd, supra,* 470 U.S. at p. 220, fn. 6.) After the enactment of the FAA, the

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Thus, the identical phrasing in the FAA's original procedural provisions together with its legislative history reflects a congressional intent that the two sections apply to federal courts.

Further, the United States Supreme Court does not read the FAA's procedural provisions to apply to state court proceedings. "[W]e do not hold that §§ 3 and 4 of the Arbitration Act apply to proceedings in state courts. Section 4, for example, provides that the Federal Rules of Civil Procedure apply in proceedings to compel arbitration. The Federal Rules do not apply in such state court proceedings." (*Keating, supra,* 465 U.S. at p. 16, fn. 10.) In *Volt*, the high court later confirmed that, "While we have held the FAA's 'substantive' provisions – §§ 1 and 2 – are applicable in state as well as federal court [citation], we have never held that §§ 3 and 4, which by their terms appear to apply only to proceedings in federal court [citations], are nonetheless applicable in state court." (*Volt, supra,* 489 U.S. at p. 477, fn. 6.) Reaffirming *Volt's* distinction between the procedural and substantive aspects of the FAA, the court further described section 1281.2(c) as "determin[ing] only the efficient order of proceedings [and] not affect[ing] the enforceability of the arbitration agreement itself." (*Doctor's Associates, supra,* 517 U.S. at p. 688.)

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American Bar Association, which had participated in drafting the legislation, stated that "[t]he statute establishes a procedure in the Federal courts for the enforcement of arbitration agreements. [¶] A Federal statute providing for the enforcement of arbitration agreements does relate solely to procedure of the Federal courts." (ABA Com. on Commerce, Trade & Commercial Law (1925) *The United States Arbitration Law and its Application,* 11 A.B.A.J. 153, 154.)

Finally, our interpretation that the procedural provisions of the FAA and section 1281.2 do not conflict is consistent with our prior decision in *Rosenthal*. (*Rosenthal, supra,* 14 Cal.4th 394.) *Rosenthal* dealt with the differences between the procedural provisions in section 4 of the FAA (9 U.S.C. § 4), designating that a jury decides the existence and validity of an arbitration agreement, and sections 1281.2 and 1290.2, designating that a court decides that issue. We determined that: (1) the wording of section 4 suggests it is limited to federal courts and (2) the state procedural rules do not frustrate or defeat section 2's policy of enforcement of arbitration agreements. (*Rosenthal, supra,* 14 Cal.4th at pp. 407-410.) We explained that: "[T]he federal policy of ensuring enforcement of private arbitration agreements, centrally embodied in section 2, is not self-implementing; its effectuation requires that courts have available some procedure by which a party seeking arbitration may compel a resisting party to arbitrate. Section 4 of the [FAA] establishes one such procedure; state law may or may not provide for other equivalent or similar procedures." (*Rosenthal, supra,* 14 Cal.4th at p. 408.) "Like other federal procedural rules, therefore, 'the procedural provisions of the [FAA] are not binding on state courts . . . *provided applicable state procedures do not defeat the rights granted by Congress.*' [Citation.]" (*Rosenthal, supra,* 14 Cal.4th at p. 409.) "Our statutes do establish procedures for determining enforceability not applicable to contracts generally, but they do not thereby run afoul of the [FAA's] section 2, which states the principle of equal enforceability, but does not dictate the procedures for determining enforceability." (*Rosenthal, supra,* 14 Cal.4th at p. 410.)

Appellants rely on specific language in *Volt* and on the holdings of *Byrd* and *Moses H. Cone*. *Volt* stated: "Where, as here, the parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA, even if the result is that arbitration is stayed *where the Act would otherwise permit it to go forward.*" (*Volt, supra,* 489 U.S. at p. 479 italics added.) Appellants argue that, in the absence of the all-encompassing state choice-of-law provision in *Volt* the *Volt* court would have found that the FAA preempts section 1281.2(c). However, in *Volt,* the high court, for purposes of argument, simply *assumed* that the procedural rules of the FAA (9 U.S.C. §§ 3 and 4) applied in state courts. (*Volt, supra,* 489 U.S. at p. 477 ["we conclude that even if §§ 3 and 4 of the FAA are fully applicable in state court proceedings, they do not prevent application of [Code Civ. Proc.] § 1281.2(c) to stay arbitration where, as here, the parties have agreed to arbitrate in accordance with California law"].)

Similarly, in *Byrd* and *Moses H. Cone* (federal diversity cases), the procedural rules of the FAA clearly applied to those federal court proceedings. *Byrd* required a federal district court to grant a party's motion to compel arbitration of the pendant state arbitrable claims, pursuant to sections 3 and 4 of the FAA (9 U.S.C. §§ 3 and 4). (*Byrd, supra,* 470 U.S. at pp. 217-218, 223-224.) Noting the legislative history of the FAA, the court commented that the act "declares simply that such agreements for arbitration shall be enforced, and provides a procedure in the Federal courts for their enforcement.' H.R.Rep. No. 96, 68th Cong., 1st Sess., 1-2 (1924)." (*Byrd, supra,* 470 U.S. at p. 220, fn. 6.) Also relying on the procedural rules of the FAA, *Moses H. Cone* held that the federal district court

erred in staying the federal court action seeking an order compelling arbitration, pending resolution of a concurrent state court suit. (*Moses H. Cone, supra*, 460 U.S. at pp. 21-26.) Thus, *Byrd* and *Moses H. Cone* do not address the appropriate procedure in state courts.

We must still address appellants' claim that section 1281.2(c) conflicts with the spirit of the FAA because its application would undermine and frustrate 9 United States Code section 2's policy of enforceability of arbitration agreements. They argue that, under the rule of liberal construction set forth in *Moses H. Cone*, due regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the arbitration clause should be resolved against the application of the conflicting state rule. (*Moses H. Cone, supra*, 460 U.S. at pp. 24-25 ["The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability."].)

*Volt* answered a similar claim. There, the contractor argued that the California Court of Appeal offended the *Moses H. Cone* principle by interpreting the choice-of-law provision to mean that the parties intended the California rules of arbitration, including the section 1281.2(c) stay provision, to apply to their arbitration agreement. In rejecting that claim, the high court responded: "Interpreting a choice-of-law clause to make applicable state rules governing the conduct of arbitration – *rules which are manifestly designed to encourage resort to the arbitral process* – simply does not offend the rule of liberal construction set forth in *Moses H. Cone*, nor does it offend any

other policy embodied in the FAA." (*Volt, supra,* 489 U.S. at p. 476 italics added.) The court further stated: "[W]e think the California arbitration rules which the parties have incorporated into their contract generally foster the federal policy favoring arbitration. As indicated, the FAA itself contains no provision designed to deal with the special practical problems that arise in multiparty contractual disputes when some or all of the contracts at issue include agreements to arbitrate. California has taken the lead in fashioning a legislative response to this problem, by giving courts authority to consolidate or stay arbitration proceedings in these situations in order to minimize the potential for contradictory judgments. See Calif. Civ. Proc.Code Ann. § 1281.2(c)." (*Id.* at p. 476, fn. 5.) Because "[t]here is no federal policy favoring arbitration under a certain set of procedural rules" (*id.* at p. 476), the Court of Appeal's construction of the arguably ambiguous generic choice-of-law clause – as incorporating both the state substantive law and state pro-arbitration rules (rather than the FAA) – did not violate the *Moses H. Cone* principle. (*Ibid.*)

In contrast, the high court, in *Mastrobuono v. Shearson Lehman Hutton, Inc.* (1995) 514 U.S. 52 (*Mastrobuono*), reached a result which, at first blush, might appear to be inconsistent with *Volt,* but is not. Applying the *Moses H. Cone* principle, it found that the generic choice-of-law clause in that case incorporated the state substantive law, but not state arbitration rules. *Mastrobuono* involved the interpretation of a standard form contract between a securities brokerage firm and its customers, requiring arbitration. The choice-of-law provision provided that the contract "'shall be governed by the laws of the State of New York.'" (*Id.* at p. 53.) The arbitration provision

contained no express reference to claims for punitive damages. New York decisional law allowed courts, but not arbitrators, to award punitive damages (the *Garrity* rule).[7] A panel of arbitrators awarded punitive damages, but a federal district court and federal Court of Appeal disallowed the award. (*Mastrobuono, supra,* at pp. 54-55.)

The petitioners argued that the FAA preempted the *Garrity* rule, while the respondents relied on *Volt,* arguing that the choice-of-law provision incorporated state arbitration rules, including the *Garrity* rule. The high court responded: "[a]t most, the choice-of-law clause introduces an ambiguity into an arbitration agreement that would otherwise allow punitive damage awards. As we pointed out in *Volt,* when a court interprets such provisions in an agreement covered by the FAA, 'due regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the arbitration clause itself resolved in favor of arbitration.' [Citations.]" (*Mastrobuono, supra,* 514 U.S. at p. 62.) "We think the best way to harmonize the choice-of-law provision with the arbitration provision is to read 'the laws of the State of New York' to encompass substantive principles that New York courts would apply, *but not to include special rules limiting the authority of arbitrators.* Thus, the choice-of-law provision covers the rights and duties of the parties, while the arbitration clause covers arbitration; neither sentence intrudes upon the other." (*Id.* at pp. 63-64 italics added.)

One commentator cogently explained the seemingly inconsistent results in *Volt* and *Mastrobuono*: "In *Volt,* the state policy *furthered* the federal goal of encouraging

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[7] *Garrity v. Lyle Stuart, Inc.* (1976) 40 N.Y.2d 354.

arbitration, and thus *Moses H. Cone* did not require construing ambiguities toward applying the FAA. In *Mastrobuono,* however, the policy at issue would have directly *impeded* the FAA's goals, thus triggering the FAA preemption. As a result, it should hardly be surprising that a choice-of-law clause, in an agreement bound by the contract law and involving the arbitration rules of one state, happened to produce a different result than did a choice-of-law clause in an entirely different context." (Note, *An Unnecessary Choice of Law: Volt, Mastrobuono, and Federal Arbitration Act Preemption* (2002) 115 Harv. L.Rev. 2250, 2259-2260 fns. omitted.)

Unlike the *Garrity* rule addressed in *Mastrobuono*, section 1281.2(c) is *not* a special rule limiting the authority of arbitrators. It is an evenhanded law that allows the trial court to stay arbitration proceedings while the concurrent lawsuit proceeds *or* stay the lawsuit while arbitration proceeds to avoid conflicting rulings on common issues of fact and law amongst interrelated parties. Moreover, "[s]ection 1281.2(c) is not a provision designed to limit the rights of parties who choose to arbitrate or otherwise to discourage the use of arbitration. Rather, it is part of California's statutory scheme designed to enforce the parties' arbitration agreements, as the FAA requires. Section 1281.2(c) addresses the peculiar situation that arises when a controversy also affects claims by or against other parties not bound by the arbitration agreement. The California provision giving the court discretion not to enforce the arbitration agreement under such circumstances – in order to avoid potential inconsistency in outcome as well as duplication of effort – does not contravene the letter or the spirit of the FAA. That was the explicit holding in *Volt* and nothing in *Mastrobuono* casts

doubt on that conclusion." (*Mount Diablo, supra,* 101 Cal.App.4th at p. 726.) Thus, we need not construe any ambiguities as to the scope of the arbitration provision against the application of section 1281.2(c).[6]

Our opinion does not preclude parties to an arbitration agreement to *expressly* designate that any arbitration proceeding should move forward under the FAA's procedural provisions rather than under state procedural law. We simply hold that the language of the arbitration clause in this case, calling for the application of the FAA "if it would be applicable," should not be read to preclude the application of 1281.2(c), because it does not conflict with the applicable provisions of the FAA and does not undermine or frustrate the FAA's substantive policy favoring arbitration.

## CONCLUSION

For the reasons stated above, we affirm the judgment of the Court of Appeal.

CHIN, J.

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[6] We decline to follow *Wolsey, Ltd. v. Foodmaker, Inc.* (9th Cir. 1998) 144 F.3d 1205 in which the court relied on *Mastrobuono* and concluded that section 1281.2(c) governs the allocation of power between alternative tribunals and limits the authority of arbitrators. Accordingly, it interpreted that the generic choice-of-law provision did not incorporate section 1281.2(c) and precluded the federal district court from applying the state rule. We also disapprove *Warren-Guthrie v. Health Net* (2000) 84 Cal.App.4th 804 and *Energy Group, Inc. v. Liddington* (1987) 192 Cal.App.3d 1520 to the extent their holdings are predicated on the conclusion that section 1281.2(c) limits the authority of arbitrators and conflicts with the FAA.

WE CONCUR:

GEORGE, C.J.
KENNARD, J.
BAXTER, J.
WERDEGAR, J.
BROWN, J.
MORENO, J.

No. 05-355

In The
# Supreme Court of the United States

SSW, INC.,

*Petitioner,*

v.

REGENTS OF THE
UNIVERSITY OF CALIFORNIA,

*Respondent.*

**On Petition For Writ Of Certiorari**
**To The Supreme Court Of California**

## BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

ROLAND NIKLES
*Counsel of Record*
ROGER M. HUGHES
ERIC J. PHILLIPS
BELL, ROSENBERG & HUGHES LLP
1300 Clay Street, Suite 1000
Oakland, CA 94612-0220
(510) 832-8585

STEVEN P. MORRELL
DAVID BERGQUIST
THE REGENTS OF THE UNIVERSITY OF CALIFORNIA
1111 Franklin Street, 8th Floor
Oakland, CA 94607-5200
(510) 987-9800

COCKLE LAW BRIEF PRINTING CO (800) 225-6964
OR CALL COLLECT (402) 342-2831

## QUESTIONS PRESENTED

I. Does this court have jurisdiction to review a state court's interpretation of a private contract, where neither the validity of a state statute nor the validity of a federal statute is drawn into question?

II. Where parties to a contract involving interstate commerce designate California law as the rule of decision, specify California arbitration rules, and provide that the agreement to arbitrate shall be enforceable under the prevailing arbitration law, does it offend the Supremacy Clause for California courts to enforce that agreement by applying section 1281.2(c) of the California Code of Civil Procedure?

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## THERE IS NO BASIS OF JURISDICTION

Petitioner asserts that this court has jurisdiction pursuant to 28 U.S.C. §1257(a) and 9 U.S.C. §16(a). The asserted basis of jurisdiction is lacking.

Except for situations in which Congress has specifically authorized collateral review of state court judgments, a party who seeks to overturn a state court judgment must proceed through the state judicial system; a party can only seek review in the United States Supreme Court pursuant to 28 U.S.C. §1257. *4901 Corporation v. Town of Cicero*, 220 F.3d 522 (7th Cir. 2000). This Court does not have jurisdiction pursuant to 28 U.S.C. §1257(a). Section 1257(a) provides that the United States Supreme Court may review the decree rendered by the highest court of a state in which a decision could be had, where (1) the validity of a treaty or statute of the United States is drawn in question, or (2) where the validity of a statute of any state is drawn in question (a) on the grounds of it being repugnant to the Constitution, treaties, or laws of the United States, or (b) where any right, privilege or immunity is specially set up or claimed under the Constitution or the treaties or statutes of . . . the United States. The petition in this case challenges neither a treaty nor statute of the United States, nor the validity of any state law. To the contrary, the petition concedes the validity of Cal. Code Civ. Proc. §1281.2(c), and its relationship to the Federal Arbitration Act, 9 U.S.C. §§1-16, as set forth in *Volt Information Sciences, Inc. v. Board of Trustees*, 489 U.S. 468 (1989). Petitioner does not claim any right, privilege or immunity under the Constitution, a treaty, or a statute of the United States. The sole right petitioner claims arises from its private agreement. The interpretation of that agreement

by the California Court of Appeal in this case does not raise a reviewable issue under 28 U.S.C. §1257(a).

Petitioner erroneously asserts that the Court has jurisdiction because "this petition for a writ of certiorari arises from the denial of SSW's petition to compel arbitration." Petition, p. 1. The Federal Arbitration Act, however, is not jurisdiction-granting. *Klein v. Drexel Burnham Lambert, Inc.*, 737 F. Supp. 319 (D. Pa. 1990). Moreover, a state court's denial of a motion to compel arbitration, on the grounds that the parties intended the state court arbitration procedures to apply, is not one of the enumerated grounds for appeal mentioned in 9 U.S.C. §16.

## STATEMENT OF THE CASE

Irrespective of the jurisdictional issue, this case does not present a substantial federal question for review by this Court. The California Court of Appeal in this case, routinely and appropriately, applied settled federal and state law holding that arbitration is a matter of agreement between the parties to the contract. The courts in this case correctly enforced the parties' agreement, which provides that California law, including California's arbitration procedures, will be applied to any dispute between them.

In *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989) the court noted that, unlike its federal counterpart, the California Arbitration Act, Cal. Code Civ. Proc. Ann. §1280 *et seq.* (West 1982), contains a provision allowing a court to

stay arbitration pending resolution of related litigation.[1] The Court held that application of the California statute, Cal. Code Civ. Proc. §1281.2(c), is not pre-empted by the Federal Arbitration Act, 9 U.S.C. §1 *et seq.*, in a case where the parties have agreed that their arbitration agreement will be governed by California law.

In this case, as outlined in the California Court of Appeal's decision (Petition, p. 6a), the parties unequivocally agreed that their arbitration agreement will be governed by California law. The contract between the parties contained the following choice of law provisions:

> "*Governing laws.* This Contract Order shall be governed by, and enforced in accordance with the laws of the State of California, exclusive of conflicts by laws provisions."
>
> "*Arbitration*: If the foregoing procedures do not resolve the dispute, the dispute shall be decided by arbitration in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association then prevailing as supplemented by Section 1282.6, 1283 and 1283.05 of the California Code of Civil Procedure, unless the parties mutually agree otherwise. Selection of arbitrators shall be in accordance with rules of

[1] The court, in *Volt*, found that the California arbitration rules generally foster the federal policy favoring arbitration. Noting that the Federal Arbitration Act contains no provision designed to deal with the special practical problems that arise in multiparty contractual disputes when, as in the present case, some or all of the contracts at issue include agreements to arbitrate. The court lauded California for taking the lead in fashioning a legislative response to this problem, by giving courts the authority to consolidate or stay arbitration proceedings in these situations in order to minimize the potential for contradictory judgments. *Volt*, 489 U.S. 468, note 5.

> the American Arbitration Association. The Arbitrator(s) shall be bound by, and apply California law. Each party hereto expresses consent that any arbitration arising of [*sic*] or relating to this Agreement, or the breach thereof, may, at the option of either party, include by consolidation, joinder or in any other manner, other persons involved in or affected by such claim, dispute or other matter. . . . The foregoing agreement to arbitrate . . . shall be specifically enforceable under the prevailing Arbitration Law. The award rendered by the Arbitrators shall be final, and the judgment may be entered upon it in accordance with applicable law in any court having jurisdiction thereof. All arbitration proceedings hereunder shall, unless all parties hereto otherwise agree, be conducted in the County of San Francisco."

In *Volt*, the California Court of Appeal held that by specifying that their contract would be governed by "the law of the place where the project is located," the parties had incorporated the California rules of arbitration, including Cal. Code Civ. Proc. §1281.2(c), into their arbitration agreement. 489 U.S. at 470. In this case, the objective intent of the parties was even clearer. Interpretation of private contracts by state courts, of course, is a question of state law, which this Court does not sit to review. See, *Volt*, 489 U.S. at 494. Moreover, as the court indicated in *Volt*, "Where, as here, the parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA, even if the result is that arbitration is stayed

where the Act would otherwise permit it to go forward." *Id.* at 472.[2]

## STATEMENT OF FACTS

In early 1994, the Regents of the University of California (Regents) contracted with Walsh Construction Company (Walsh) for construction and renovation of a Central Utilities Plant at the Parnassus campus of the University of California, San Francisco, California (Project). The Petitioner entered into a subcontract with Walsh to supply and install two heat recovery steam generators, and related equipment, for the Project.[3] The subcontract was for the express benefit of the UC Regents. After the project was underway, Walsh's parent company filed for bankruptcy. Project sureties, Fidelity and Deposit Company of Maryland and Universal Underwriters Insurance Company, took assignment of Walsh's obligations and rights under Walsh's contract with the Regents. Many problems arose on the Project, and in June 1999, the UC Regents filed suit against the sureties in California State Court to recover on the performance bond. On June 8, 2001, the Regents amended their complaint to include a cause of action against Petitioner and others.

[2] In *Volt*, the court addressed, and resolved, the validity of Cal. Code of Civil Procedure §1281.2(c) *vis-à-vis* the FAA. The validity of this statute, or any statute, is not at issue in this case. The only issue presented by this case is the contract interpretation issue, and this is why this Court had jurisdiction in *Volt*, and the Court does not have jurisdiction in this case.

[3] Petitioner entered into a subcontract with Walsh Construction as National Dynamics Corporation. SSW, Inc. (SSW) subsequently acquired all assets and liabilities of National Dynamics Corporation.

The contract between Walsh and SSW includes a choice of law clause that specifically states that the contract is to be enforced under California law. The contract also provides that the arbitration agreement shall be enforced under California law. The agreement between the Regents and Walsh, the general contractor, however, did not contain an arbitration provision. SSW filed a petition to compel arbitration, which was denied, pursuant to Cal. Code Civ. Proc. §1281.2(c), on the grounds that there was a potential for inconsistent rulings if the controversy were adjudicated in multiple forums.

The California Court of Appeal affirmed the decision. The Court of Appeal focused on the parties' general choice of law (California) and the choice of law for arbitration (California), and correctly concluded that the parties intended their arbitration clause to be subject to §1281.2(c). SSW appealed to the California Supreme Court which, after initially accepting review pending its decision in another case, declined to hear the case. Pursuant to California appellate procedure, the Court of Appeal decision became final when the Supreme Court dismissed its review of the case.

## REASONS WHY CERTIORARI SHOULD BE DENIED

### I. NO FEDERAL LAW ISSUE IS PRESENTED IN THIS CASE

This case presents no substantial federal question for review by this Court. The California Court of Appeal simply followed settled federal and state law holding that arbitration is a matter of agreement between the parties.

The Court of Appeal enforced the parties' agreement, including their choice of law for arbitration, according to the objective intent that is manifest in the agreement. For this reason, this Court lacks jurisdiction to grant the petition. See pp. 1-2, above.

### A. The Court Of Appeal Properly Looked To The Contract Language To Determine The Objective Intent Of The Parties.

The unanimous thirty-one page Court of Appeal decision in this case relies on California's law of contract interpretation. Petitioner concedes that the Court of Appeal's decision "turned upon the interpretation of the arbitration agreement." See, Petition, p. 11. The Court of Appeal determined that, in the absence of extrinsic evidence to the contrary, it must look to the language of the contract to determine the intentions of the parties.

A state court's interpretation of a choice of law clause in a privately negotiated agreement does not present a question for review by this Court. Additionally, the determination that state law applies does not conflict with the FAA or burden a federal right because the purpose of the FAA is to ensure enforcement of parties' agreements, not to replace those agreements. In this case, the Court of Appeal relied on three clauses in the contract between Petitioner and Walsh. First, the agreement included a general California choice of law clause; second, the arbitration provision in the agreement made reference to specific provisions of the California Arbitration Act and provided that the arbitrator would be bound by California law; and third, the agreement provided that the arbitration agreement would be enforced under California law. The provision reads as follows: "The foregoing agreement

to arbitrate . . . shall be specifically enforceable under the prevailing Arbitration Law." Civil Code Section 1281.2 is found in Title 9, Chapter 2 of the Code of Civil Procedure, which is entitled "Enforcement of Arbitration Agreements." In the context of the overall provision, therefore, there can be no doub that "prevailing Arbitration Law" means California Arbitration Law. In other words, the California Court of Appeal's determination that the parties intended to have Cal. Code Civ. Proc. §1281.2 apply to their agreement, is unremarkable and manifestly reasonable. Any interpretation of the contract other than that made by the California Court of Appeal would be inconsistent with the intent of the parties as expressed in the contract and would undermine the purpose of the FAA to enforce the parties' agreement.

### B. Petitioner Misapprehends And Distorts The Effect Of The California Supreme Court's Dismissal Of Its Review Of The Present Case; Petitioner Further Distorts The Holding Of The Factually And Legally Disparate Decision In *Cronus*.

Petitioner embarks on a flight of fancy by suggesting that the California Supreme Court, by dismissing review of this case, somehow "evince(d) a conclusion" that "section 1281.2(c) should apply ***irrespective*** of the intent of the parties."[4] This flagrantly distorts what the California

[4] Petitioner also incorrectly states: "However, the California Supreme Court did not examine or opine on the lower court's conclusions, which turned upon the interpretation of the arbitration agreement. Instead, the court relied solely upon its decision in *Cronus* to reject SSW's petition to compel arbitration. [¶]The *Cronus* decision had openly rejected the parties' contractual agreement as to the law that

(Continued on following page)

Supreme Court did in this case, and what the Court said in *Cronus Investment, Inc. v. Concierge Services, LLC*, 107 P.3d 217 (Cal. 2005). The California Supreme Court never issued a decision in this case; to the contrary, the Court dismissed its review of this case. See Petition 1a. This dismissal automatically made the opinion of the Court of Appeal final. Cal. R. of Court 29.3(b). In other words, the Court of Appeal decision, not some fanciful construct that Petitioner incorrectly attributes to the Supreme Court, reflects the final word on this case by the California courts.[5]

Petitioner further exhibits a lack of understanding of California appellate procedure when it asserts that "The California Supreme Court, pursuant to Cal. Rules of Court 29.3(b), could have ordered the publication of the court of appeal decision if the opinion below was intended to be the law of the State," and concludes (incorrectly) that, because the Court did not order the Court of Appeal decision to be published, this somehow requires Petitioner to imagine an

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would govern the arbitration agreement and, instead, presumptively applied California law ***as a default*** (emphasis in original)." Petition, p. 11. Of course, this is pure fiction. The California Supreme Court did no such thing: the Court simply dismissed the petition for review, which made the Court of Appeal's decision the final word on this matter in the California courts. The California Rules of Court, Rule 29.3(b) states: "(1) The Supreme Court may dismiss review. . . . (2) When the Court of Appeal receives an order dismissing review, the decision of ***that*** court becomes final and its clerk must promptly issue a remittitur or take other appropriate action. (3) After an order dismissing review, the Court of Appeal opinion remains unpublished unless the Supreme Court orders otherwise." (Emphasis added).

[5] See Petition, pp. 4a-24a.

implied holding by the California Supreme Court – a holding that was never made by any court, anywhere.[6]

### C. The California Courts Do Not Apply A *De Facto* Presumption To Determine What Law Governs Arbitration Agreements. Petitioner Distorts And Misrepresents The Cases.

Petitioner incorrectly alleges that California courts rely on a *de facto* presumption that California law governs arbitration clauses. There is nothing in the history of the present case, or in any of the cases on which Petitioner relies, to indicate the existence of such a presumption.

To support its false assertion that the California courts apply a *de facto* presumption to conclude that California law applies to arbitration clauses, SSW rewrites the holdings of four California cases. Every case upon which Petitioner relies to demonstrate such a supposed bias, in reality involves a thorough investigation by the respective court of the contracting parties' objective intent. The method of contract interpretation employed by these cases is consistent with the purpose of the FAA and with this Court's decisions in *Volt* and *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995).

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[6] See Petition, footnote 4. Decisions of the California Courts of Appeal are not published unless a decision establishes a new rule of law, conflicts with existing law, involves an issue of continuing public interest, or makes a significant contribution to legal literature. Cal. R. of Court 976. When a California Court of Appeal decision is not published, as in this case, the only proper conclusion that can be drawn is that the case is consistent with existing California law.

### i. *Cronus Investment, Inc. v. Concierge Services, LLC*

The central focus of SSW's petition is the decision in *Cronus Investment, Inc. v. Concierge Services, LLC*, which, it claims, shows that California is ignoring contracting parties' intentions in order to apply California law. 107 P.3d 217 (2005). Even the most topical review of the California Supreme Court Decision in *Cronus*, however, indicates that the Court looked to the parties' objective intent rather than applying a *de facto* presumption.

While Petitioner is correct that the contract in *Cronus* called for arbitration under the terms of the Federal Arbitration Act "if it would be applicable," both parties conceded that their selection of California law in the choice of law clause meant that California law applied to the arbitration clause insofar as it was not inconsistent with the FAA. *Id.* at 219. This concession meant that the California Supreme Court was not required to further investigate the parties' intent. Relying on this Court's decision in *Volt*, the California Supreme Court held that Cal. Code Civ. Proc. §1281.2(c) is consistent with the FAA, and that its application was appropriate in that case. *Volt*, 489 U.S. at 472.

More egregiously, as noted above, Petitioner suggests that in *Cronus* the California Supreme Court held that §1281.2(c) should apply in this case, "*irrespective* of the intent of the parties." Petition p. 13. Of course *Cronus* makes no mention whatsoever of the present case, and the

holding that is incorrectly imputed by Petitioner is directly contrary to what the court in *Cronus* said. 107 P.3d 217.[7]

### ii. *Mount Diablo Medical Center v. Health Net of California, Inc.*

In *Mount Diablo Medical Center v. Health Net of California, Inc.*, the California Court of Appeal found as a matter of contract interpretation that when the parties to a contract indicate in a choice of law clause that the contract is to be *enforced* under California law, the parties intend the arbitration clause to be governed by California law. 124 Cal. Rptr. 2d 607 (Cal. Ct. App. 2002). The Court of Appeal derives the parties' intent directly from the

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[7] "The parties (do) dispute whether they intended that section 1281.2(c) procedures would govern the enforcement of those contracts that contain the arbitration provisions. Under United States Supreme Court jurisprudence, we examine the language of the contract to determine whether the parties intended to apply the FAA to the exclusion of California procedural law and, if any ambiguity exists, to determine whether section 1281.2(c) conflicts with or frustrates the objectives of the FAA." Petition, at 33a. . . . "The parties seem to agree that the broad choice-of-law provision generally incorporates California law, including the California Arbitration Act (CAA) (§1280 et seq.), of which section 1281.2(c) is a part." See Petition, at 38a. "Our opinion does not preclude parties to an arbitration agreement to *expressly* designate that any arbitration proceeding should move forward under the FAA's procedural provisions rather than under state procedural law. We simply hold that the language of the arbitration clause in this case, calling for the application of the FAA "if it would be applicable," should not be read to preclude the application of 1281.2(c), because it does not conflict with the applicable provisions of the FAA and does not undermine or frustrate the FAA's substantive policy favoring arbitration." See Petition, at 50a.

terms of the contract and does not rely on any *de facto* presumption.[8]

### iii. *Discover Bank v. Superior Court*

Petitioner incorrectly asserts that in *Discover Bank v. Superior Court* the California Supreme Court disregarded the selection of Delaware law with respect to the enforceability of a class action waiver. 30 Cal. Rptr. 3d 76 (Cal. 2005).[9] In fact, the opposite is true. The California Supreme Court remanded the case for determination of whether the Delaware choice of law clause required enforcement of the class action waiver. *Id* at 79. This case stands in direct opposition to Petitioner's suggestion that the California courts are applying a *de facto* presumption that California law governs arbitration agreements.

### iv. *Frankhouse v. Roth Capital Partners, LLC*

Petitioner cites to *Frankhouse*, No. G033765, 2005 WL 1406004 (Cal. App. June 16, 2005) in violation of Cal. R. of Court 977, which bars the citation of unpublished opinions.[10] Additionally, Petitioner mischaracterizes the

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[8] The court held as follows: "We interpret the authorities on the subject to require the court to look first to the language of the contract to determine what portions of state law the parties intended to incorporate, and then, if any ambiguity exists, to determine whether the provision in question conflicts with the objectives of the FAA. Under this approach, we conclude that the parties intended to incorporate California procedural law governing the enforcement of their agreement to arbitrate, and that these provisions are not preempted. Therefore we affirm." 124 Cal. Rptr. 2d 607, 608.

[9] Petitioner improperly cites this case at 113 P.3d 1100 (Cal. 2005).

[10] Rule 977. Citation of opinions. (a). Unpublished opinion. Except as provided in (b), an opinion of a California Court of Appeal or superior

(Continued on following page)

decision in *Frankhouse*. The Court of Appeal in that case did not apply a *de facto* presumption that California law would apply. There, the Court of Appeal only resorted to California law after the parties repeatedly failed and refused to present the court with relevant New York law that might apply. *Id.* The Court noted that, although the agreement between the parties appeared to contain a New York choice of law clause, neither party raised this as an issue relevant to the arbitration question with the trial judge. *Id.* They neglected to raise the New York law issue either before or after learning of the trial judge's intent to deny their motion to compel arbitration based on California law. *Id.* Throughout, the parties relied on California law in their motion to compel arbitration: the parties even failed to mention or discuss the New York choice of law clause in their letter briefs after the appellate court directed their attention to the clause in oral argument. *Id.* In the absence of any engagement by the parties on this issue, and pursuant to established California authority, the California Court of Appeal reasonably assumed that there must be no relevant distinction in the applicable law and looked to California law to solve the problem. *Id.* Regardless, of course, this decision bears no relation to the case at bar, which included, not one, but three choice of law clauses requiring that the contract be enforced under California law.

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court appellate division that is not certified for publication or ordered published must not be cited or relied on by a court or a party in any other action. (b). Exceptions. An unpublished opinion may be cited or relied on: (1) when the opinion is relevant under the doctrines of law of the case, res judicata, or collateral estoppel, or (2) when the opinion is relevant to a criminal or disciplinary action because it states reasons for a decision affecting the same defendant or respondent in another such action.

Although Petitioner goes to great lengths to attempt to demonstrate a *de facto* presumption in California law, going so far as to mischaracterize the holding of four cases, and citing a case in contravention of the California Rules of Court, there is no *de facto* presumption – the cases cited by Petitioner simply confirm that California Courts are interpreting contractual arbitration agreements consistent with the intent of the parties.

## CONCLUSION

The petition for writ of certiorari should be denied.

Dated this 19th day of October, 2005.

Respectfully submitted by:

ROLAND NIKLES
*Counsel of Record*
ROGER M. HUGHES
ERIC J. PHILLIPS
BELL, ROSENBERG & HUGHES LLP
1300 Clay Street, Suite 1000
Oakland, CA 94612-0220
(510) 832-8585

STEVEN P. MORRELL
DAVID BERGQUIST
THE REGENTS OF THE UNIVERSITY OF CALIFORNIA
1111 Franklin Street, 8th Floor
Oakland, CA 94607-5200
(510) 987-9800

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No. 05-355

In The
# Supreme Court of the United States

SSW, INC.,

*Petitioner,*

v.

REGENTS OF THE UNIVERSITY OF CALIFORNIA,

*Respondent.*

On Petition For Writ Of Certiorari
To The Supreme Court of California

## REPLY IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

KERRY L. KESTER
*Counsel of Record*
JOEL D. HEUSINGER
KRISTA L. KESTER
ALLEN M. TATE
WOODS & AITKEN LLP
SUITE 500
301 SOUTH 13TH STREET
LINCOLN, NE 68508-2578
(402) 437-8500

MICHAEL E. LONDON
MCINERNEY & DILLON, P.C.
ONE KAISER PLAZA
18TH FLOOR
OAKLAND, CA 94612
(510) 465-7100

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## RESPONSE TO OPPOSITION

### I. THIS COURT HAS JURISDICTION UNDER § 1257(a) BECAUSE THE PETITIONER CLAIMS THE VIOLATION OF A RIGHT SPECIALLY CLAIMED UNDER FEDERAL LAW.

The Regents' argument that there is no basis for jurisdiction is incorrect and must be rejected. First, the Regents' construction of 28 U.S.C. § 1257(a) would limit its grant of jurisdiction to instances in which the terms of a legislative or executive enactment are called into question. In doing so, the Regents ignore the very terms of § 1257(a) that authorize review under three sets of circumstances, the third of which is "where any . . . right . . . is specially set up or claimed under the Constitution . . . or statutes of . . . the United States." *Id.* § 1257(a); *see also* 2 *Fed. Proc., L. Ed.* § 3:116 (recognizing the Supreme Court's jurisdiction to review state court decisions by writ of certiorari to exist in any of above three instances). This basis for jurisdiction stands on footing equal to that of the two provisions addressing the validity of state and federal statutes and treaties, and is not, as the Regents contend, simply a subset of the provision relating to a state statute's validity.[1]

Most compelling in this regard is the Court's recent review of a final judgment of the South Carolina Supreme Court in *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003). The decision under review in *Green Tree* dealt

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[1] This Court has found jurisdiction, pursuant to § 1257, in numerous cases where the petitioner challenged judicial application of an otherwise valid state statute. *E.g., Cohen v. California,* 403 U.S. 15, 17-18 (1971); *Warren Trading Post v. Arizona Tax Comm'n,* 380 U.S. 685, 686 & n.1 (1965); *Bantam Books, Inc. v. Sullivan,* 372 U.S. 58, 61 n.3 (1963); *Dahnke-Walker Milling Co. v. Bondurant,* 257 U.S. 282 (1921).

exclusively with the state court's construction (under state common law) of an arbitration agreement and whether that construction violated the Federal Arbitration Act, 9 U.S.C. §§ 1-16 ("FAA"). Thus, the Court has rejected soundly the Regents' position that this Court has no jurisdiction over claims arising from the judicial construction of a private agreement.

The Court's jurisdiction to review state court decisions not directly challenging the constitutionality of statutory enactments is critical. In fact, the Court has an "independent obligation" to scrutinize state judgments that defeat the enforcement of federal rights. *Howlett v. Rose,* 496 U.S. 356, 366 n.14 (1990). "The reasons for that rule rest on nothing less than this Court's ultimate authority to review state-court decisions in which 'any title, right, privilege, or immunity is specially set up or claimed under the Constitution.'" *Id.* To hold otherwise would create an undeniable and intolerable opportunity for state courts to avoid the jurisdiction of the United States Supreme Court.

Second, the Regents disingenuously conclude that "Petitioner does not claim any right, privilege or immunity under the Constitution, a treaty, or a statute of the United States, nor the validity of any state law." (Resp. in Opp'n at 1.) Yet, the Regents' own Statement of the Case notes the Federal Arbitration Act, the very statute under which the Petitioner claims a right. (Resp. in Opp'n at 3.)

While it is true that SSW does not disagree with the rule articulated in *Volt Information Sciences, Inc. v. Board of Trustees*, 489 U.S. 468 (1989), that concession does not defeat jurisdiction in this case because § 1257(a) specifically authorizes review of the California Supreme Court's ruling that runs afoul of the decision in *Volt.* It is in this respect

that the Petitioner challenges the application of Cal. Code Civ. Proc. § 1281.2(c) as a violation of federal law.[2]

## II. THIS CASE PRESENTS SUBSTANTIAL ISSUES OF FEDERAL LAW THAT WARRANT REVIEW.

The Regents' assertion that the California appellate court decisions "simply follow settled federal" law utterly ignores the manner in which those courts have distorted well-established federal law relating to the supremacy of the federal arbitration law. The resulting impairment of the rights afforded by federal arbitration law is evident from a comparison of the rule articulated by this Court in *Volt* and that more recently set forth by the California Supreme Court in *Cronus Investment, Inc. v. Concierge Services, LLC*, 107 P.3d 217 (Cal. 2005). While *Volt* established that the FAA will permit the enforcement of agreements to arbitrate under "different rules than those set forth" in the FAA as long as the parties contractually specify those rules, 489 U.S. at 479, the decision in *Cronus* specifies that California rules will apply unless the parties "expressly designate that any arbitration proceeding should move forward under the FAA's procedural provisions rather than under state procedural law." App. 50a. Thus, the California Supreme Court has categorically imposed California law (including the stay provision of section 1281.2(c)) upon parties to an arbitration agreement unless the parties expressly assert their

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[2] In their argument that jurisdiction is lacking because 9 U.S.C. § 16(a) does not grant jurisdiction to the Supreme Court, the Regents fail to recognize that § 16(a) is referenced with respect to jurisdiction because it addresses the "finality" requirement necessary to invoke jurisdiction under § 1257(a). Moreover, the finality requirement is also satisfied in this case by virtue of the Cal. Code Proc. § 1294 which makes appealable "an order dismissing or denying a petition to compel arbitration." *See* App. 8a at n.4 (taking jurisdiction of this case under section 1294(a) of the appeal from the order denying SSW's motion to compel arbitration).

right to enforcement as intended by the FAA and this Court's decision in *Volt*.

The conflicting rules announced in *Volt* and *Cronus* are not only inconsistent, they are mutually exclusive because they designate ***different*** bodies of law to be followed in the absence of a specific contractual provision. It goes without saying that law as established by this Court will not be relegated from its position of prominence by state courts that flaunt federal law.

### A. The Contract Construction Imposed Upon SSW Contravenes The Terms Of SSW's Subcontract And, Thus, Cannot Survive Judicial Scrutiny In Light Of The FAA.

The opportunity and need to grant a writ of certiorari in this case is not diminished by the Regents' contention that this is just a case about contract interpretation. Even if that is the case, which SSW contends it is not, judicial scrutiny of contract construction is not beyond the permissible scope of review by the Supreme Court. Without repeating SSW's earlier discussion on this point, the deference generally afforded state court decisions of that type is not unlimited and this Court can, and should, review those determinations if they infringe upon important federal rights. *See also* Pet. at 24-25.

Indeed, former Chief Justice Rehnquist urged this Court to undertake just such a review in *Green Tree*, 539 U.S. 444, 459 (2003) (Rehnquist, C.J., dissenting and joined by O'Connor, J. and Kennedy, J.). In his dissent, the former Chief Justice concluded that the contract interpretation given by the South Carolina Supreme Court to an arbitration provision was "contrary to the express agreement of the

parties" and did not, therefore, enforce the agreement according to its terms. *Id.* Therefore, in his view, the judgment springing from that erroneous construction should have been reversed.

The dissenting opinion in *Green Tree* stands in stark contrast to the majority's refusal to scrutinize the state court's contract interpretation in *Volt*. The Court will recall that Chief Justice Rehnquist wrote the majority opinion in *Volt*. Thus, the views held and expressed by Chief Justice Rehnquist in those two cases establishes that, when the record so warrants, Supreme Court review of the interpretations given to contracts involving arbitration is both permissible and appropriate. The instant case presents just such a circumstance.

Second, no principled analysis would render the term "prevailing Arbitration Law" as referring "automatically" to California arbitration law in this context. In fact, this Court would likely find just the opposite to be true under the principles announced in other cases involving the interpretation of arbitration provisions.

The provisions of the arbitration clause refer to four ***different*** sets of laws or rules that, when taken together, preclude the interpretation given by the lower court and dictate the conclusion that "prevailing Arbitration Law" is intended to be the FAA.[3] Each calls out a body of law ***separate and distinct*** from the law to be applied under the other portions of the arbitration provision:

(i) The arbitration is to be "conducted" in accordance with the AAA rules, supplemented by sections

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[3] For the text of the arbitration provision, *see* Pet. at 7 n.2.

1282.6, 1283, and 1283.05 of the California Civil Code rules (addressing the use of subpoenas);

(ii) The *arbitrators* are to be "bound by and apply" California law, and;

(iii) The arbitration is to be "specifically enforceable" in accordance with prevailing "Arbitration Law."

Notably, the only reference to California law in the arbitration provision directs the *arbitrators* to apply California law. That provision is not a generic reference to the law to be applied to the parties' dispute. Moreover, the question of *whether* the arbitration agreement is enforceable is to be determined by "Arbitration Law," without any reference to California.[4] It is obvious that the parties specifically identified different laws to govern different aspects of the agreement to arbitrate and that the conclusion pressed by the Regents is hardly "automatic."

### B. SSW's Reliance Upon *Cronus* Neither Distorts The Decision Nor The Role Of That Decision As It Relates To SSW's Petition For Writ Of Certiorari.

SSW has not misapprehended the effect of the reliance placed on *Cronus* by the California Supreme Court in

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[4] The Subcontract's incorporation of "Arbitration Law" rather than California law with respect to enforcement is even more significant when considered in conjunction with the general choice-of-law clause that specifies that "California law" will govern the Subcontract. One must wonder why, if the parties really intended for "Arbitration Law" to be California law, an additional enforcement term was necessary? In fact, had the parties intended to incorporate the entirety of California's law on arbitration, why was it necessary to expressly call out the three discovery provisions or any other reference to the law to be applied or followed by the arbitrators? In short, it *was* necessary to do so because the parties intended the FAA to govern the enforcement of the arbitration provision.

dismissing SSW's petition for review. The Regents erroneously conclude that the manner in which the California Supreme Court dismissed review of SSW's appeal automatically makes the opinion of the California Court of Appeal the final word on SSW's case. (Resp. Br. in Opp'n at 9.)

The Regents fail to address, however, the fact that the California Supreme Court did *not* simply dismiss SSW's petition. Rather, the court dismissed SSW's petition "[i]n light of the decision in *Cronus Investments, Inc., v. Concierge Services.*" App. 1a. In so doing, the California Supreme Court specifically identified *Cronus* as the law it viewed as controlling the issues raised by SSW's appeal.

The California Supreme Court could have dismissed SSW's petition for review in a number of manners. First, it could have dismissed review without comment, thereby indicating that the decision of the court of appeal stood but that there was no reason to publish the court of appeal decision. The court did not do so. Instead, the appeal was disposed of in light of *Cronus*.

Second, the court could have dismissed SSW's appeal and ordered the publication of the court of appeal decision, thereby indicating the court of appeal decision was correct and of some value as precedent. Again, the court did not do so.

Third, the court could have dismissed SSW's appeal "in light of" some controlling principle, case, or statute, thereby establishing that principle or case as the law of the land and as the basis for dismissal of SSW's appeal. The California Supreme Court did precisely this. In fact, this method of

disposal of SSW's appeal was not an anomaly but has been employed in other cases. *See* Pet. at 8-9 n.4.

More importantly, in establishing *Cronus* as the basis for its decision on SSW's appeal, the court fully articulated the very presumption that begs this Court's review. The California court has made quite clear that, when presented with an arbitration agreement, the court will apply California procedural and arbitration law, including § 1281.2(c), *unless* the parties expressly designate the FAA to govern. App. 50a. Such a holding and rule of contract interpretation does not resolve doubts in favor of arbitration. Nor does it indicate any deference to the FAA. In fact, it eviscerates rights supposedly guaranteed to contracting parties under the FAA and this Court's precedents, including *Volt*.

Moreover, it appears unlikely that an arbitration agreement has yet been drafted that will satisfy the California court's requirement for such a designation. This Court's review of SSW's case is crucial because it takes little effort to mouth words indicating "a careful examination of the objective intent of the contracting parties." As is evident, the rights guaranteed by the FAA are easily nullified by a court's willingness to presume that parties intended to incorporate section 1281.2(c) into an arbitration agreement where the plain language of the agreement clearly indicates quite the opposite intent or, at a minimum, some ambiguity.

### C. The Presumption Favoring California Law Is Evident In The Recent Decisions Of The California Appellate Courts And Warrants Review By This Court.

It is, indeed, fanciful to suggest (as the Regents do) that the California courts merely have applied the law to the

parties' stated intentions in the arbitration agreements. Time and again, the California appellate courts have disregarded the parties' stated intent and looked for an angle pursuant to which section 1281.2(c) could be applied. Despite the Regents' contentions, the cases cited by SSW cannot be reconciled to the requirement of *Volt* that the FAA shall apply unless the parties expressly indicate otherwise.

First, the Regents merely repeat what SSW set forth in its Petition regarding *Mount Diablo Medical Center v. Health Net of California Inc.*, 124 Cal. Rptr. 2d 607 (Cal. Ct. App. 2002); that is, that *Mount Diablo* created a rule that the designation of law with respect to the "enforcement" of a contract would also apply to the enforcement of the arbitration agreement. That rule was not, however, followed when subsequent cases presented contracts that specified a choice of law *other than California* for the enforcement of the arbitration agreement. *See* Pet. at 19-20.

Second, the decision in *Discover Card v. Superior Court of Los Angeles*, 113 P.3d 1100 (Cal. 2005), confirms, as SSW contends, that the California courts will *not* abide by the parties' stated intent to use law *other than* California law to govern the enforcement of an arbitration provision. In that case, the parties undisputedly selected Delaware law, yet the California Supreme Court disregarded that designation. Instead, the matter was remanded for a conflict of law analysis to determine whether *California* law should apply even though the contract designated Delaware law.

The Regents' discussion of *Frankhouse v. Roth Capital Partners, LLC*, No. G033765, 2005 WL 1406004 (Cal. Ct. App. June 16, 2005), cannot overcome the fact that the parties had expressly designated New York law, and that the state court disregarded that choice of law in lieu of

California's law. As discussed in the opening Petition, under federal jurisprudence, any ambiguity in the law should have been resolved *in favor of arbitration*.[5]

Judicial scrutiny will reveal the fallacy of the Regents' closing suggestion that the California courts have simply followed the express intent of the parties. As a litany of cases now demonstrate, the persistent pattern in those courts has been to frustrate and disregard the stated intent of the parties, and to find some alternative theory by which to invoke the stay provision of section 1281.2(c) despite the clarity of the parties' agreement to invoke some other law.

## CONCLUSION

Wherefore, the petition for writ of certiorari should be granted and the decisions below reversed.

Dated this 31st day of October, 2005.

KERRY L. KESTER
*Counsel of Record*
JOEL D. HEUSINGER
KRISTA L. KESTER
ALLEN M. TATE
WOODS & AITKEN LLP
301 SOUTH 13TH STREET
LINCOLN, NE 68508-2578
(402) 437-8500

MICHAEL E. LONDON
MCINERNEY & DILLON, P.C.
ONE KAISER PLAZA
18TH FLOOR
OAKLAND, CA 94612
(510) 465-7100

[5] The Regents' assertion that *Frankhouse* may not properly be cited or considered by this Court because it was an "unpublished opinion" should be disregarded because the rule is not binding upon federal courts *See, e.g., In re Temporomandibular Joint Implants Lit.*, 113 F.3d 1484, 1493 n.11 (8th Cir. 1997); *Ortiz-Sandoval v. Gomez*, 81 F.3d 891, 895 (9th Cir. 1996).